

MODIFIED FINAL JUDGMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

OVERSIGHT HEARING ON THE MODIFIED FINAL JUDGMENT

DECEMBER 10 AND 11, 1987

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

81-754 O

WASHINGTON : 1987

5261-33

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ERNEST F. HOLLINGS, South Carolina, *Chairman*

DANIEL K. INOUE, Hawaii	JOHN C. DANFORTH, Missouri
WENDELL H. FORD, Kentucky	BOB PACKWOOD, Oregon
DONALD W. RIEGLE, JR., Michigan	NANCY LONDON KASSEBAUM, Kansas
J. JAMES EXON, Nebraska	LARRY PRESSLER, South Dakota
ALBERT GORE, JR., Tennessee	TED STEVENS, Alaska
JOHN D. ROCKEFELLER IV, West Virginia	ROBERT W. KASTEN, JR., Wisconsin
LLOYD BENTSEN, Texas	PAUL S. TRIBLE, JR., Virginia
JOHN F. KERRY, Massachusetts	PETE WILSON, California
JOHN B. BREAUX, Louisiana	JOHN MCCAIN, Arizona
BROCK ADAMS, Washington	

RALPH B. EVERETT, *Chief Counsel and Staff Director*

W. ALLEN MOORE, *Minority Chief of Staff*

SUBCOMMITTEE ON COMMUNICATIONS

DANIEL K. INOUE, Hawaii, *Chairman*

ERNEST F. HOLLINGS, South Carolina	BOB PACKWOOD, Oregon
WENDELL H. FORD, Kentucky	LARRY PRESSLER, South Dakota
ALBERT GORE, JR., Tennessee	TED STEVENS, Alaska
J. JAMES EXON, Nebraska	PETE WILSON, California
JOHN F. KERRY, Massachusetts	JOHN MCCAIN, Arizona

CONTENTS

Opening statement by Senator Inouye.....	Page 1
Opening statement by Senator Pressler.....	69

CHRONOLOGICAL LIST OF WITNESSES

DECEMBER 10, 1987

DeMaeyer, Bruce, president, Ameritech Services.....	56
Prepared statement.....	58
Levetown, Robert A., executive vice president and general counsel, Bell Atlantic...	17
Prepared statement.....	18
Questions of Senator Pressler and the answers.....	21
Marks, Herbert E., counsel, Independent Data Communications Manufacturers Assn.....	45
Prepared statement.....	47
Letter of December 21, 1987.....	52
Roberts, Bert C., president, MCI.....	25
Prepared statement.....	26
Sampson, Curt, president, Communications Systems, Inc., on behalf of U.S. Telecommunications Suppliers Assn.....	53
Snedaker, Robert, president, US print.....	21
Prepared statement.....	22
Zeglis, John D., senior vice president and general counsel, AT&T.....	2
Prepared statement.....	4
Questions of Senator Stevens and the answers.....	16

DECEMBER 11, 1987

Opening statement by Senator Inouye.....	73
Boren, C. Sidney, vice president, Corporate Planning and Budget, Bell South.....	74
Prepared statement.....	77
Cox, Maurice A., executive vice president, information services division, Compuserve, Inc.....	100
Prepared statement.....	102
DeMuth, Laurence W., Jr., executive vice president, general counsel, and secretary, U.S. West.....	83
Prepared statement.....	84
Letter of February 25, 1988.....	89
Field, Michael S., vice president, customer information systems, Dun and Bradstreet Corp.....	113
Letter of February 16, 1988.....	116
Kimmelman, Gene, legislative director, Consumer Federation of America.....	110
Prepared statement.....	111
Martz, Uzal H., Jr., president and publisher, Pottsville Republican, representing the American Newspaper Publishers Assn.....	91
Prepared statement.....	93

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Competitive Telecommunications Assn., statement.....	132
Computer and Business Equipment Manufacturers Assn., statement.....	140
Gabbard, O. Gene, chairman, managing committee, National Telecommunications Network, statement.....	131
Geller, Henry, and others, letter.....	144
Metzenbaum, Hon. Howard M., U.S. Senator from Ohio, letter.....	141
Pacific Telesis Group, statement.....	135
Wirth, Hon. Timothy E., U.S. Senator from Colorado, letter.....	150

MODIFIED FINAL JUDGMENT

THURSDAY, DECEMBER 10, 1987

U.S. SENATE,
SUBCOMMITTEE ON COMMUNICATIONS,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:24 p.m., in room SR-253, Russell Senate Office Building, Hon. Daniel K. Inouye (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: Tom Cohen and John Windhausen, staff counsels; and Katherine Meier and Gina Keeney, minority staff counsels.

OPENING STATEMENT BY SENATOR INOUE

Senator INOUE. The hearings of today and tomorrow are a continuation of the subcommittee's longstanding interest in common carrier issues and the Modified Final Judgment. I am certain many of you will remember the exhaustive hearings the Chairman of the committee, Senator Hollings, held a decade ago. They laid the foundation for later hearings by Senator Packwood and Senator Goldwater, and for the passage of legislation through the Senate in 1981.

After the parties to the AT&T antitrust case entered into a consent decree, the subcommittee again held hearings. These were most recently followed by the September 1986 hearings by Senator Danforth on legislation to transfer the administration and enforcement of the modified final judgment from the district court to the Federal Communications Commission.

We now meet, first to examine the decision by Judge Greene on September 10 rejecting the recommendations by the Department of Justice to remove most of the restrictions on the Bell Operating Co. imposed in the modified final judgment, and second, to review the comments filed in response to the judge's request for further definition of the functions that the Bell Operating Co. may provide in offering gateway services for information service providers.

The subcommittee also intends to review other proceedings of the district court such as its record on waivers, and the just-issued decision on the definition of manufacturing.

The committee views the hearings over the next two days as the beginning of the most recent efforts by the subcommittee in this area. The witness list is relatively short today, particularly in relationship to the many parties that wish to testify. Large business users, state regulators, independent and rural telephone companies and many other interests are not represented in today's and tomorrow's

row's panels. Neither are representatives of the Federal Government. It is for that reason that these hearings will continue next year, and the subcommittee wishes to hear from all parties on these very important matters.

Today the subcommittee will hear views on two of the areas where entry by Bell Operating Co. is restricted: long distance services and manufacturing. We have key representatives from the Bell Operating Co. to testify as to why these restrictions should be lifted, and from those who oppose such action.

I wish to thank all of you who have taken the time to appear with us this afternoon. Before I do, my apologies for this delay, but we are having an important measure under consideration at this time, and I had a few amendments to put in.

Our first panel will discuss long distance services, and we have with us the Senior Vice President and General Counsel of AT&T, Mr. John D. Zeglis; and the Executive Vice President and General Counsel of Bell Atlantic, Mr. Robert Levetown; the President of U.S. Sprint, Mr. Robert Snedaker; and the President of MCI, Mr. Bert C. Roberts, Jr.

Welcome, gentlemen.

I believe Mr. Zeglis goes first.

STATEMENT OF JOHN D. ZEGLIS, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, AT&T

Mr. ZEGLIS. Thank you, Mr. Chairman.

As your first witness, Mr. Chairman, let me suggest that your look at conditions in our industry might be enhanced by reviewing the issues in the full sweep of our industry's competitive history, of which Judge Greene's September 10 decision was really just one consistent chapter.

At least from the end of the 1940's until very early this year, the Government pressed a consistent objective on our industry, confine the Bell System to its monopoly operations, separate away its competitive businesses.

Now, the Government's first antitrust case in that era began in 1949 and ended in 1956 with a decree that limited the System to what was then thought to be an effective monopoly, running a national telephone network and manufacturing equipment for it. Bell got out of its other businesses.

By 1974, market conditions had changed, but the government's policy was consistent. Now, two more pieces of the Bell System were competitive, the long distance piece of its network and manufacturing equipment. Consistently, the government brought an antitrust case to separate these competitive businesses from what were still monopolies, the local exchanges. The reason was the long distance competitors absolutely depended upon our exchanges to reach their customers. The exchanges were bottlenecks, and they were supposedly being abused.

Now, that is the case that ended in 1982 with the consent decree and the 1984 divestiture of the monopolies, the local exchanges. And the purpose was to end all this controversy over whether the exchanges were being abused. And so, of course, the other side of the coin, an absolutely non-negotiable demand from the govern-

ment, was that the divested exchanges be restricted from building back into long distance companies and manufacturers. Otherwise, the government said, and they were right, the whole divestiture would have been futile. We would soon regenerate all the controversies that we set out to end.

Then finally we come to 1987 and this triennial review with the court taking another look and finding what not a single party could seriously contest, and that is that the exchanges are still monopolies. So, consistently, Judge Greene reaffirmed these core injunctions with respect to long distance and manufacturing and made some other changes that loosened restrictions and that we were able to support.

Now, Mr. Chairman, this is a sound outcome in our opinion, but I will say in all candor, it has taken AT&T a very long time to accept this industry structure as good policy. We fought it every way we knew how in the 1970's, and we lost it everywhere. We said the FCC had preemptive jurisdiction over the Sherman Act, but the FCC and all the courts said no, the antitrust laws apply. We said we had not abused our position, but the government and more than 70 plaintiffs tied us up in massive cases anyway. We said we could compete fairly, but the state commissions, the state legislatures, the FCC, this Congress, this committee were always at work to devise new rules of fair play.

All of this combined to put our industry into a gridlock. Rather than focusing on the marketplace, we were all litigating and maneuvering and waiting, month after month, year after year, to see what the new rules would be. And the only way out was that clean, functional split of the system, a separation of the competitive businesses from the local exchanges, and that necessary counterpart, the injunctions against recreating the same structural problem by letting the exchanges build back into long distance companies and manufacturers.

What is more, Mr. Chairman, we look back, and it has worked. Competition has flourished in this industry since divestiture. In the long distance market, the FCC is now listing over 500 competitors of all sizes and shapes. They have driven down long distance prices dramatically. They are well financed; they have access to technology; they have enormous capacity already built into their network; they have attracted millions of new customers.

And in manufacturing, Mr. Chairman, we have the same situation. The United States is the most open market in the world. Competitors there vary from hundreds of smaller producers to the global giants, and again, the equipment prices have come way, way down.

Under all the circumstances, Mr. Chairman, with these local exchange monopolies still in place, with the Sherman Act continuing in full force and effect, we submit we have a result that represents a sensible application of the nation's antitrust laws in furtherance of its competitive policies. The industry's new structure is both pro competitive and pro consumer, which happens to complement very nicely similar goals of the Communications Act without interfering in the least with the FCC's important jurisdiction.

In our opinion, Mr. Chairman, there is no need for the committee or the Congress to undertake changes in that scheme.

Thank you very much.
[The statement follows:]

STATEMENT OF JOHN D. ZEGLIS ON BEHALF OF AT&T

Mr. Chairman and members of the Committee: My name is John D. Zeglis. I am Senior Vice President and General Counsel of American Telephone and Telegraph Company ("AT&T"). We greatly appreciate the Committee's invitation to appear today to discuss conditions under the Modification of Final Judgment (sometimes referred to as the "Decree") and the Court's recent decision that modified two of the Decree's four line of business injunctions on the divested Bell Operating Companies ("BOCs") and their Regional Holding Companies ("RHCs").

My testimony is divided into three parts. First, it will discuss the antitrust basis and background for the Decree and how the Decree was a response to initiatives of the Congress and the FCC as well as a decade of antitrust proceedings. Second, it will describe how the experience of the last three years has witnessed the very competitive conditions and consumers benefits that the antitrust laws are designed to advance. Third, my testimony will address the Court's recent holding that there have been insufficient changes in the divested local exchange facilities to modify the Decree's two core line of business injunctions—interexchange services and the manufacture of telecommunications products—but that the other two injunctions could be modified.

I. THE ANTITRUST BASIS FOR THE DECREE

The Modification of Final Judgment granted the United States the structural antitrust relief that the Justice Department had sought in over three decades of antitrust litigation with the formerly integrated Bell System. The January 1, 1984, divestiture split the Bell System between its monopoly local exchange businesses (assigned to the BOCs) and its competitive long distance and manufacturing businesses (assigned to AT&T). The Decree originally contained four line of business injunctions and barred the BOCs from (1) interexchange services, (2) equipment manufacturing, (3) information services, and (4) nontelecommunications businesses.

The line of business injunctions are the "necessary counterpart" of this divestiture. By precluding the BOCs from reentering the long distance and manufacturing businesses, the line of business injunctions assure that the divested BOCs will not recreate the very combinations and controversies that the divestiture was designed to end. At the same time, the Decree was carefully fashioned to create an industry structure for telecommunications that would not only promote competition in long distance, manufacturing, and other markets, but also protect ratepayers, prevent balkanization of the national network, and promote America's international competitiveness and balance of payments.

Both the divestiture and the corresponding line of business injunctions received broad support among the 600 commentators that participated in the public interest proceedings which led to the entry of the Decree by District Judge Harold H. Greene. And each rests on a fact that Judge Greene, the Court of Appeals for the District of Columbia Circuit, and numerous other antitrust courts have recognized: it creates profound competitive controversies and threatens vital national interests for a BOC both to control local exchange networks on a widespread basis and to participate in competitive businesses that depend on "access" to these local exchanges or information about them.

These points are demonstrated by a brief review of (1) the antitrust litigation against the Bell System, (2) the fact that state and federal public utility regulation could not prevent these controversies, (3) the enormous costs that this antitrust problem imposed on the nation, and (4) the explicit antitrust findings that the District Court made when the Decree was entered and that appellate courts have since reaffirmed.

1. The 1949 and 1974 Government Antitrust Cases And The More Than 70 Private Suits

Prior to 1984, the Bell System has been a single enterprise that participated in monopoly and related competitive businesses alike. Through the BOCs, the Bell System owned the local telephone exchanges, which everyone recognized to be natural monopolies that could not feasibly be duplicated. Through AT&T and Western Electric, the Bell System also participated in three actually or potentially competitive businesses that depended on access to the local exchange monopolies: (1) long distance or "interexchange" services, which require access to local telephone facilities to originate and terminate calls; (2) the manufacture of telecommunications

equipment (including equipment located on customer premises), most of which was purchased by the BOCs and all of which requires access to information about the evolving technical characteristics of the network's local exchange; and (3) the provision of a very few "information services" (i.e., time, weather, and sports information), which similarly require use of local telephone facilities for transmission of the information.

In the 35 years that led up to the Decree, the United States brought two separate antitrust actions to break up the Bell System: the first in 1949 (*United States v. Western Electric*, No. 17-49 (D.N.J.)) and the second in 1974 (*United States v. AT&T*, No. 74-1698 (D.D.C.)). The basis for each was the Justice Department's contention that the structure of the Bell System was inherently anticompetitive.

The Department proceeded under the theory that a firm with a lawful monopoly violates Section 2 of the Sherman Act if it "leverages" that monopoly to impeded or foreclose competition in a related market—even if the firm neither monopolizes nor attempts to monopolize that second market—and that a monopolist acquires special duties if it controls an "essential facility" or a "strategic bottleneck" to which competitors require nondiscriminatory access.¹ Judge Harold Greene and other courts found that this dual control over the local telephone exchange monopolies and related competitive business gave the Bell Companies both the "ability" and the "incentive" to foreclose competition in the long distance and equipment manufacturing markets through discrimination and cross-subsidization. See, e.g., *United States v. AT&T*, 552 F. Supp. 131, 187 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983); *Litton Systems, Inc. v. AT&T*, 700 F.2d 785, 798-802 (2d Cir. 1983), *cert. denied*, 404 U.S. 1073 (1984).

Equipment Manufacturing.—The Department claimed that the Bell System's control over the local telephone exchanges inherently foreclosed competition in equipment manufacturing markets. In the Department's view, the Bell System could, and had, misused its local monopolies to foreclose competition in these markets in three different ways.

First, in numerous episodes in *United States v. AT&T*, the Department charged that the BOCs and their centralized engineering affiliate, Bell Laboratories, had "discriminated" against the Bell System's manufacturing competitors in providing access to essential technical and engineering information about the local exchange networks. Specifically, the Department contended that the Bell System's manufacturing affiliate, Western Electric, had been provided with preferential access to technical data, compatibility standards, information about the BOCs' needs and requirements, and other information about the evolving characteristics of the local exchanges that was essential to the design and manufacture of equipment for sale to the BOCs. See Plaintiff's Memorandum in Opposition to Defendant's Motion For Involuntary Dismissal, *United States v. AT&T*, No. 74-1698 (D.D.C.), pp. 49-51, 269-359, 366-410 (August 16, 1981) (hereinafter cited as "August 16, 1981, DOJ Memorandum") Competitive Impact Statement, *United States v. AT&T*, No. 74-1698 (D.D.C.), p. 15 (February 10, 1982) (hereinafter cited as "Competitive Impact Statement").

For example, the Department alleged that, "[b]y setting technical or compatibility standards and by either not communicating these standards to the general trade or changing them in mid-stream," the Bell System gave its manufacturing affiliate a "headstart" and insuperable advantages in designing equipment for use with the BOCs' local exchanges. See *United States v. AT&T*, 524 F. Supp. 1336, 1372 (D.D.C. 1981). This headstart allegedly assured that Western Electric would have only products on the market that met the BOCs' requirements, such that the product could be purchased at inflated prices, and regulatory authorities would have no realistic alternative to passing these inflated prices through to ratepayers. See August 16, 1981, DOJ Memorandum, pp. 49-51; Competitive Impact Statement, pp. 15, 40-42.

Second, the Department claimed that the BOCs had "subsidize[d] the prices of their equipment with the revenues from their monopoly services." *United States v. AT&T*, 552 F. Supp. at 190. This allegedly permitted the BOCs to provide customer premises equipment to their customers below cost or without regard to cost, and it permitted Western Electric sales to the BOCs themselves at below-cost prices when necessary to assure that Western Electric products would be selected. Specifically,

¹ See *Otter Tail Power Co. v. United States*, 410 U.S. 366, 377 (1973); *Northern Pacific Railway v. United States*, 356 U.S. 1, 11 (1958); *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 608-09 (1953); *United States v. Griffith*, 334 U.S. 100, 107 (1948); *M.A.P. Oil Co. v. Texaco, Inc.* 691 F. 2d 1303, 1305-06 (9th Cir. 1982); *Berkey Photo Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 275-76 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980); *Sargent-Welch Scientific Co. v. Ventron Corp.*, 567 F.2d 701, 709, 711-13 (7th Cir. 1977), *cert. denied*, 439 U.S. 822 (1978).

the Department and others charged that the product design and development expenses of Western Electric had been misallocated to the systems engineering and research functions that were funded by the BOCs' payments to AT&T under the License Contract, using revenues derived from their local services. See, e.g., Plaintiff's First Statement of Contentions and Proof, *United States v. AT&T*, No. 74-1698 (D.D.C.), p. 53 (November 1, 1978); August 16, 1981, DOJ Memorandum, pp. 366, 389-91; Competitive Impact Statement, pp. 40-42. This conduct would produce both predatory pricing that harmed competition and inflated rates that harmed consumers.

Finally, the Department claimed that when Western Electric's "privileged access to information [and other conduct] failed to foreclose competition," the BOCs would simply favor their affiliate's products, even when better or cheaper alternatives were available from unaffiliated vendors. August 16, 1981, DOJ Memorandum, pp. 28-33, 376-88, 402-10; Competitive Impact Statement, p. 15. In episode after episode the Department charged this misconduct and alleged that the monopoly character of the BOCs' local exchanges gave them the ability to buy equipment at inflated prices, to the detriment of competition and consumers alike. The Department argued such a use of vertical integration to "evade" rate regulation and inflate consumers rates was a *per se* violation of Section 2 of the Sherman Act under *Byars v. Bluff City News*, 609 F.2d 843, 861 (6th Cir. 1979); 3 P. Areeda & D. Turner, *Antitrust Law* 218-19 (1978); and other like authorities. See August 16, 1981, DOJ Memorandum, pp. 362-64.

The Department further contended that the mere existence of the vertically integrated Bell System created "suspicions" that would inhibit competition, whether or not the Bell System in fact engaged in any anticompetitive abuses. The Department claimed that, whether due to the efficiencies of integration or the perceived likelihood of abuses, firms would be inhibited from entering the American market and selling products to the BOCs so long as they were affiliated with a manufacturer. See *United States v. AT&T*, 524 F. Supp. at 1379-80 (quoting August 16, 1981, DOJ Memorandum, p. 51).

Interexchange Services.—The Bell System's control over local exchanges produced equally intractable controversies in the interexchange market. The Department contended—and AT&T could not dispute—that the local exchanges were "essential facilities" for all participants in this market. The reality is that no long distance carrier can compete in this market unless it obtains access to the BOCs' local loops and other local distribution facilities that connect the long distance carrier's intercity network to consumers. Because these BOC facilities are a "natural monopoly" that no interexchange carrier can feasibly duplicate, all interexchange carriers are absolutely dependent on obtaining access to these local bottlenecks in a timely fashion and at reasonable and nondiscriminatory prices. The Department thus relied on a line of cases holding that firms controlling strategic bottlenecks must provide access to them on nondiscriminatory terms.²

The allegations in the many episodes in *United States v. AT&T* set forth a vast array of charges that Bell System companies had abused these local bottlenecks to impede interexchange competition. The Bell companies were charged with denying intercity competitors access to essential facilities; discriminatory pricing of essential facilities; negotiating in bad faith over new forms of interconnection to those facilities; misallocating joint and common costs between monopoly and competitive services to "cross-subsidize" interexchange services; engaging in "price squeezes" by charging inflated rates for local access while simultaneously lowering interexchange rates; delaying release of the interface information that long distance carriers need to develop new services; and continually "shifting from one anticompetitive activity to another." See *United States v. AT&T*, 552 F. Supp. at 167; August 16, 1981, DOJ Memorandum, pp. 67-285; *United States v. AT&T*, No. 74-1698, Plaintiff's First Statement of Contentions and Proof, pp. 74-258 (November 1, 1978). In the Department's view, all this actual or possible conduct foreclosed competition, inhibited entry, and injured consumers and competition alike.

These allegations were not limited to the two government antitrust suits. More than 70 private antitrust cases were brought against Bell companies under these

² The Department analogized the BOCs' local exchanges to such "essential facilities" as the stadium in *Hecht v. Pro-Football, Inc.*, 570 F.2d 982 (D.C. Cir. 1977), cert. denied, 436 U.S. 956 (1978); the warehouse in *Genco, Inc. v. Providence Fruit & Produce Bldg., Inc.*, 194 F.2d 484 (1st Cir.), cert. denied, 344 U.S. 817 (1952); the railroad terminal in *United States v. Terminal R.R. Ass'n*, 224 U.S. 383 (1912); the pipeline in *Woods Exploration & Producing Co. v. Aluminum Co. of America*, 438 F.2d 1286 (5th Cir. 1971), cert. denied, 404 U.S. 1047 (1972); and the power transmission facilities in *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973). See August 16, 1981, DOJ Memorandum, pp. 39, 76; *United States v. AT&T*, 524 F. Supp. at 1352-53.

same leveraging theories by interexchange carriers,³ equipment manufacturers,⁴ and other competitors.

2. Regulation

A principal Bell System defense to these antitrust charges was that, almost without exception, the challenged conduct was not only subject to regulation, but had actually been reviewed or approved by the FCC or the state utility commissions that regulated the Bell System companies.

Indeed, the existence of this regulation had been the basis for the 1956 Judgment that settled the Department of Justice's 1949 complaint. In the 1956 Judgment, the parties stipulated to the entry of a judgment that did not order any structural relief, but that, instead, limited the Bell System to the provision of regulated services and the manufacture of equipment used for such regulated services—thereby relying on regulation to prevent future abuses of the telephone monopoly. It subsequently became apparent, however, that neither the 1956 Judgment nor state and federal regulation could prevent future controversies over claimed abuses of the local exchange monopolies, especially when competition was introduced into interexchange services and aspects of the equipment business. The Government case filed in 1974 and the more than 70 private antitrust cases of this period were filed in response to this reality.

Consistent with the 1956 Judgment, AT&T contended in each of these cases that the conduct of the Bell companies was immune from attack under the antitrust laws because that conduct was pervasively regulated by the FCC and state public utility commissions. AT&T argued that the pervasive common carrier regulation to which the Bell companies were subject under the Communications Act of 1934 (47 U.S.C. § 151, *et seq.*) and corresponding state public utility laws was inherently inconsistent with the free and open competition that the antitrust laws are designed to foster, and that to apply the antitrust laws to pervasively regulated conduct would unfairly impose conflicting standards and requirements on the regulated company. Accordingly, AT&T contended that the application of the antitrust laws was repugnant to the regulatory scheme and that antitrust immunity was necessary to enable the regulatory scheme to work.

Shortly after the filing of the government's complaint in the 1974 case, the District Judge who was then assigned to the case—Joseph C. Waddy—stayed all other activity in the case and requested the parties and the FCC as *amicus curiae* to brief this basic jurisdictional issue. Both the FCC and the Department of Justice contended that the FCC's regulatory authority over the conduct being challenged in the case did not displace the antitrust laws and did not deprive the Court of jurisdiction to order injunctive relief. See Memorandum of Federal Communications Commission As *Amicus Curiae* (filed December 30, 1975).

The Court agreed. It held that neither the Communications Act nor the FCC's regulation had impliedly repealed the antitrust laws or otherwise deprived the Court of antitrust jurisdiction over the case. *United States v. AT&T*, 427 F. Supp. 57, 61 (D.D.C. 1976), *cert. denied*, No. 77-1009 (D.C. Cir.), *cert. denied*, 429 U.S. 1071, 434 U.S. 966 (1977). Both the Court of Appeals for the District of Columbia Circuit and the Supreme Court declined to review that decision. In 1978, after the case was reassigned to Judge Harold Greene, the District Court reconsidered the immunity issue and reaffirmed that "regulation by the Federal Communications Commission and state regulatory bodies does not immunize defendants in this antitrust action." *United States v. AT&T*, 461 F. Supp. 1314, 1320-30, (D.D.C. 1978). AT&T made identical immunity claims in numerous private antitrust cases brought against the Bell

³ See, e.g., *Southern Pacific Communication Co. v. AT&T*, 556 F. Supp. 825 (D.D.C. 1982), *aff'd*, 740 F.2d 980 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985); *MCI Communications Corp. v. AT&T*, 708 F.2d 1081 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983); *Data Transmission Corp. v. AT&T*, No. 76-1544 (D.D.C.); *MCI Communications Corp. v. AT&T*, No. 79-1182 (D.D.C.); *Southern Pacific Communications Corp. v. AT&T*, No. 83-0094 & MDL 550 (N.D. Cal.); *United States Transmission Systems v. AT&T*, No. 82 Civ. 1986 (S.D.N.Y.).

⁴ See, e.g., *International Telephone & Telegraph Corp. v. AT&T*, No. 77 Civ. 2854 (S.D.N.Y.); *Conrac Corp. v. AT&T*, No. 82 Civ. 2330 (S.D.N.Y.); *Telesciences v. AT&T*, No. 80-2445 (D.D.C.); *General Dynamics Corp. v. AT&T*, No. 82-C-7941 (N.D. Ill.); *Glictronix Corp. v. AT&T*, No. 82-4447 (D.N.J.); *Gregg Communication Systems v. AT&T*, No. 82-C-6291 (N.D. Ill.); *Jack Faucett Assoc., Inc. v. AT&T*, No. 81-1804 (D.D.C.) (and four consolidated cases); *KWF Industries, Inc. v. AT&T*, No. 83-0431 (D.D.C.); *Phonetele, Inc. v. AT&T*, No. 74-3566-FW (C.D. Cal.); *Rice International Corp. v. AT&T*, No. 82-2573 (S.D. Fla.); *Selectron, Inc. v. Pacific Northwest Bell Telephone Co.*, No. 76-965-BE (D. Ore.); *Sound, Inc. v. AT&T*, No. 76-182-2 (S.D. Iowa) (and one consolidated case); *DASA Corp. v. AT&T*, No. 83-2695 (E.D. Pa.); *Amtel Communications, Inc. v. AT&T*, No. 82-8754 (S.D.N.Y.); *Telephonic Equipment Corp. v. AT&T*, No. 82-C-8478 (S.D.N.Y.).

System companies. These claims were rejected by each federal court of appeals that considered them, with the Supreme Court refusing to review these decisions.⁵

In its 1974 case, the Department of Justice also introduced extensive evidence to prove that regulation cannot assuage the antitrust problem created by the combination of exchange, monopolies and related competitive businesses—and that structural relief was essential. The Department's evidence showed that the local telecommunications network is so complex, so technologically dynamic, and characterized by such great joint and common costs that existing forms of public utility regulation simply could not prevent disputes or abuses. Thus, the Department claimed that regulation could not prevent discrimination in the provision and pricing of bottleneck facilities to interexchange carriers, discrimination in the provision of interface information and specifications for new products to equipment manufacturers, discrimination in the procurement of equipment, or misallocation of the BOC's joint and common costs between competitive and monopoly activities. *See, e.g.*, August 16, 1981, DOJ Memorandum, pp. 46-47, 125 n.*, 161-62, 281-82, 285, 374.

3. The Social Costs of The Antitrust Problem

The Bell System vigorously defended all the conduct that was challenged in the more than 70 public and private antitrust cases—and AT&T believes to this day that its conduct was reasonable and lawful. However, the litigation demonstrated that the mere fact of the Bell System's integration of bottleneck exchanges and related competitive businesses would continue to create antitrust controversies that threatened the Bell System, its shareholders, and the health and growth of a critical national industry—no matter who won the pending cases.

First, the dual control of the local exchange bottlenecks and competitive businesses created inherent antitrust exposure—and the certainty of enormous litigation costs. No single verdict could ever end the controversies. No matter who won *United States v. AT&T* and the other pending cases, exposure to these antitrust charges was inherent in the integrated structure of the Bell System. Under the Department's leveraging theory, virtually any competitive success by AT&T—or failure by a competitor—could be challenged in an antitrust court. A competitor could always claim that AT&T's success resulted from the misuse of its local exchange bottlenecks, not the efficiencies of integration. In each case, the allegation would raise a question of fact that would have to "go to the jury."

Equally important, the Bell System's integration of monopoly exchanges and related competitive businesses did more than create antitrust exposure that increased the Bell System's costs of doing business. It led to incessant antitrust, regulatory, and legislative proceedings throughout the 1970s and early 1980s that attempted to establish regulations that would prevent abuses of the local exchanges and thereby establish more level playing fields for the emerging competition.

For example, the risks of these anticompetitive abuses led to almost continuous congressional investigations and several legislative proposals during the last half of the 1970s and the early 1980s.⁶ In 1978, a bill was introduced in the House to require the Bell System to divest its equipment manufacturing operations within three years and to interconnect with all other carriers. H.R. 13015, 95th Cong., 2d Sess. (1978). Several additional bills were introduced in the 96th Congress that would have substantially rewritten the Communications Act to restrict potential anticompetitive conduct by the Bell companies. H.R. 3333, 96th Cong., 1st Sess. (1979); H.R. 6121, 96th Cong., 1st Sess. (1979); S. 611, 96th Cong., 1st Sess. (1979); S. 622, 96th Cong., 1st Sess. (1979); S. 2827, 96th Cong., 2d Sess. (1980). For example, H.R. 6121, was approved by the House Commerce Committee in August 1979. It would have required the Bell System to move any research and manufacturing operations that supported unregulated services or products to a separate subsidiary, and would have

⁵ *See, e.g., Southern Pacific Communications Co. v. AT&T*, 740 F. 2d 980, 999-1000 (D.C. Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985); *MCI Communications Corp. v. AT&T*, 708 F.2d 1081, 1101-05 (7th Cir. 1983), *cert. denied*, 104 S. Ct. 234 (1983); *Phoetele, Inc. v. AT&T*, 664 F.2d 716, 726-37 (9th Cir. 1981), *cert. denied*, 459 U.S. 1145 (1983); *Northeastern Telephone Co. v. AT&T*, 651 F.2d 76, 82-84 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982); *Mid-Texas Communications Systems v. AT&T*, 615 F.2d 1372, 1377-82 (5th Cir.), *cert. denied*, 449 U.S. 912 (1980); *Sound, Inc. v. AT&T*, 631 F.2d 1324, 1327-31 (8th Cir. 1980); *Essential Communications Systems v. AT&T*, 610 F.2d 1114, 1116-25 (3d Cir. 1979).

⁶ *See* H.R. 12323, 94th Cong., 2d Sess. (1976); H.R. 13015, 95th Cong., 2d Sess. (1978); 3333, 96th Cong., 1st Sess. (1979); S. 611, 96th Cong., 1st Sess. (1979); S. 622, 96th Cong., 1st Sess. (1979); H.R. 6121, 96th Cong., 1st Sess. (1979); S. 2827, 96th Cong., 2d Sess. (1980); S. 898, 97th Cong., 1st Sess. (1981); H.R. 5158, 97th Cong., 1st Sess. (1981); *MCI Communications Corp. v. AT&T*, No. 79-1182, Complaint for Violations of the Antitrust Laws, Prayer for Relief, ¶¶ 6-8 (D.D.C. April 30, 1987).

prohibited Bell companies from providing any information services that might compete with newspapers or periodicals, such as "electronic" Yellow Pages.

In 1981, the Senate passed S. 898, which is the source of several of the provisions of the Modification of Final Judgment. S. 898, 97th Cong., 1st Sess. (1981). S. 898 attempted to protect competing equipment manufacturers and suppliers from abuse of the BOC's bottleneck position by ordering structural separation of the Bell System's research, development and manufacturing operations and by imposing restrictions on the Bell Companies' purchases of equipment from its manufacturing affiliate. S. 898 sought to protect competing interexchange carriers by requiring the establishment of "exchange telecommunications areas" within the states, and further establishing a timetable for the phase-in of "equal exchange access" by the BOCs. These interexchange and exchange access provisions of S. 898 were later incorporated directly into the Decree. See Modification of Final Judgment, Sections II(A), IV(G), and Appendix B, § A.

After S. 898 passed the Senate, legislation was introduced in the House in November of 1981 (H.R. 5158, 97th Cong., 1st Sess. (1981)) that adopted radically different solutions to the threats of competitive abuses by Bell exchange companies. The FCC pursued similar regulatory solutions.⁷

The Bell System was confronted not only with the claims in *United States v. AT&T* and the private antitrust suits, but also with a host of proposed and actual FCC regulations and several legislative proposals. These all sought to limit the Bell System's ability to abuse its exchanges through such devices ranging from structural requirements, to procurement quotas, to information flow rules, to interconnection standards, to pricing regulations.

As the District Court found in 1982, the resulting uncertainty over industry structure and ground rules threatened the entire industry and the legitimate interests of all its participants. See *United States v. AT&T*, 1982-2 Trade Cases ¶ 64,726 at 71, 526 (D.D.C. 1982). For while the regulatory, legislative, and antitrust initiatives were pending, the industry participants had to wait, month after month, year after year, to learn what the "rules" and industry structure would be. While they waited, industry participants often could not move forward with new services and new investment, for fear of having to backtrack when the new "rules" were determined. Worse, industry participants bent their efforts toward prosecuting or defending the litigation (or agency or legislative proceedings) in order to influence the resulting "rules" to each participant's best advantage. As the Department of Justice contended, the mere existence of the integrated Bell System and its potential to abuse its bottleneck position inhibited many firms from entering the long distance and equipment manufacturing markets in competition with AT&T. In short, the costs of dispute dragged down all industry participants—large and small companies, actual and potential investors, and customers of all sizes.

Under the bottleneck leveraging theory, there was only one antitrust remedy that could end the crippling uncertainty and incessant controversies: AT&T's divestiture of the local exchange monopolies of the BOCs and the imposition of corresponding line of business injunctions that would prevent the divested BOCs from reentering related competitive businesses. The Department sought this precise remedy in its 1974 case, both in the pretrial proceedings and at trial—through three different administrations and the tenures of five different Attorneys General. The fact that this antitrust remedy was dictated by the Government's antitrust theory is vividly illustrated by the cover note that the then Assistant Attorney General for Antitrust (William Baxter) attached to the first draft of the Decree. It made one demand that was "non-negotiable": "the concept of separating the local exchange functions & confining the BOCs to local exchange functions" (December 21, 1981).⁸

⁷ See, e.g., *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, 77 F.C.C.2d 384 (1980) *aff'd sub nom. Computer & Communication Industry Association v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983); FCC CC Docket No. 78-72 (exchange access); FCC CC Docket No. 80-742 (license contracts); FCC CC Docket No. 80-53 and No. 19129 (Phase II) (Bell System procurement practices); *AT&T, Mannal and Procedures for the Allocation of Costs*, 84 F.C.C.2d 384, modified, 86 F.C.C.2d 667 (1981), *aff'd sub nom. MCI Telecommunications Corp. v. FCC*, 675 F.2d 408 (D.C. Cir. 1982).

⁸ Thus, the Department contended that divestiture and the Decree's line of business injunctions were "necessary complements" to one another and that the Decree's line of business injunctions are the "opposite side of the divestiture coin, . . . an integral part of the divestiture, . . . and proceed on precisely the same theory [as divestiture]." *United States v. AT&T*, No. 74-1698, Tr. 25179; *id.*, Brief of United States, p. 30 (June 14, 1982).

4. The Court's Antitrust Findings Under The Tunney Act

Although the Decree was not AT&T's idea, AT&T decided that it was the best of the available alternatives and the only way to end the turmoil and the industry's paralysis. On January 8, 1982, AT&T consented to entry of the Department's proposed decree.

Before this Decree could be entered, however, the Tunney Act required Judge Greene to conduct extensive proceedings to determine whether the relief proposal was in the public interest and to make explicit findings as to the appropriateness of this remedy. Over 600 entities submitted written comments on the Decree, including competitors in each of the relevant markets, the FCC, state utility commissions, public interest groups, and members of Congress. The commentators almost uniformly agreed that divestiture was a good idea. They also broadly agreed with the concept of line of business injunctions on the divested BOCs, although some commentators challenged some of the injunctions that the Department had proposed.

On the basis of this record and the voluminous trial record, Judge Greene found that AT&T's divestiture of the BOCs was "plainly in the public interest." *United States v. AT&T*, 552 F. Supp. at 223. Judge Greene similarly approved the line of business injunctions that would prevent the divested BOCs from reentering the interexchange and manufacturing markets that had been the subject of so many years of litigation.

The Court found that the interexchange services injunction was necessary because access to the BOCs' local exchanges is "essential" for interexchange carriers and any BOC that provided these services could disadvantage interexchange carriers in a variety of ways so long as the local exchanges remained monopolies. *id.* at 188. The Court concluded that the equipment manufacturing injunction was necessary because "[t]here is a substantial likelihood" that the BOCs would "frustrate" competition by nonaffiliated manufacturers if the BOCs were not enjoined. *Id.* at 190. Although the Court recognized that the information services market was evolving and uncertain, it also found that BOCs should also be excluded from that market "for reasons similar to those justifying the restriction on interexchange service." *Id.* at 189.⁹

At the same time, Judge Greene insisted that some of the proposed injunctions on the BOCs be *loosened* so that BOCs could participate in certain "noncore" businesses. Specifically, Judge Greene rejected the Department's proposal to enjoin the BOCs from providing "customer premises equipment" and "Yellow Pages" in connection with local exchange service. *United States v. AT&T*, 552 F. Supp. at 191-93 & 193-94. Judge Greene further modified the Decree's fourth line of business injunction: the "Catch-all" nontelecommunications services injunction that would have excluded them from all businesses other than local exchange telephone services. Rather than impose this blanket injunction, Judge Greene established a flexible "waiver" procedure under which a BOC could enter other businesses (other than long distance, manufacturing, or information services) upon a showing that there was no reasonable likelihood that their local exchanges could be leveraged to obtain improper competitive advantages.

In so doing, the Court stated—and repeatedly reiterated after divestiture—that removal of the core interexchange and manufacturing injunctions would be governed by the bottleneck leveraging theory that is the basis for the Decree. *United States v. AT&T*, 552 F. Supp. at 195. Thus, the Court stated shortly after divestiture that it would not consider proposals to allow the BOCs to participate in the core interexchange and manufacturing businesses unless and until their local exchanges ceased to be bottleneck monopolies:

"The Court will not even consider the substantive merits of a waiver request seeking permission to provide interexchange services *until such time as the Regional Holding Companies lose their bottleneck monopolies* and there is substantial competition in local telecommunications services. . . . "Similar considerations govern the

⁹In upholding these injunctions, the Court rejected arguments that the creation of seven independent BOCs or the existence of state and federal regulations could eliminate the need for the line of business injunctions in the Decree. The Court held that insofar as these injunctions and the threatened injuries to "competition, competitors, and ratepayers" are concerned, it is a "distinction . . . without a difference" that "the 'old' Bell System . . . was nationwide in scope while each of the seven Regional Companies possesses an equally powerful monopoly in [only] a particular geographic region." *United States v. Western Electric*, 627 F. Supp. 1090, 1095 (D.D.C. 1986). And the Court held that "[i]f regulation could effectively prevent the [anticompetitive] practices [by these companies], there would have been no need for the AT&T action." *United States v. AT&T*, 552 F. Supp. at 187 n. 229. See also *United States v. Western Electric Co.*, 627 F. Supp. at 1097 n. 22; *id.*, 592 F. Supp. 846, 855 & n. 20 (D.D.C. 1984).

appropriateness of entry of the Regional Holding Companies into the information services and equipment manufacturing markets. *No significant technological or structural changes have occurred in these markets* to justify a relaxation of these line of business restrictions, and no requests for waivers in these markets will be considered unless and until such changes have taken place. "*United States v. Western Electric Co.*, 592 F. Supp. at 868 & n.90 (emphasis added).

The Decree, with its line of business injunctions and the explicit standard for their removal, was affirmed by the United States Supreme Court. *Maryland v. United States*, 460 U.S. 1001 (1983). And in 1986 the appropriateness of this anti-trust remedy was reaffirmed by the Court of Appeals for the District of Columbia Circuit, in a panel of Circuit Judge James Buckley, Circuit Judge (now Justice) Antonin Scalia, and Circuit Judge Abner Mikva. *United States v. Western Electric Co.*, 797 F.2d 1082 (D.C. Cir. 1986), *cert. denied*, 107 S. Ct. 1384 (1987). As Judge Buckley's opinion stated (797 F.2d at 1088):

"We are not troubled by U.S. West's observation that the decree's expansive definition of a BOC results in broad application of the decree's [line of business injunctions and] restrictions to the [the RBOCs] and other companies affiliated with BOCs. This result is consistent with the decree's objective of sharply limiting the ability of businesses with bottleneck control of local telephone service to utilize their monopoly advantages to affect competition in competitive markets."

II. COMPETITION IN THE POST-DIVESTITURE TELECOMMUNICATIONS INDUSTRY

Experience since divestiture has clearly demonstrated that the Decree is working. The industry structure that it created *has* allowed "more rapid and certain development of competition" in the interexchange and manufacturing markets in precisely the way that the Department and the Decree Court found that it would. Competitive Impact Statement, p. 8; *United States v. AT&T* 552 F. Supp. at 160-66. As the former Chief of the Antitrust Division of the Justice Department stated last year, these markets have experienced "the introduction, at an unprecedented pace, of innovative products and services coupled with dramatic price reductions" in the three years since divestiture.¹⁰

The developments and consumer benefits in the interexchange markets could scarcely be more dramatic. New long distance companies have entered this market "in reliance upon the competitive safeguards and industry structures provided in the Consent Decree," and especially on the fact that the Decree assures that owners of essential local exchange facilities may not compete in this market. Comments of National Communications Network, *United States v. Western Electric*, No. 82-0192, p. 4 (March 13, 1987). Today, there are some 500 interexchange carriers in competition with AT&T, and these interexchange carriers have constructed over 1.7 billion circuit miles of transmission capacity—far in excess of AT&T's roughly one billion circuit miles.¹¹ Indeed, MCI has contended that competition in the interexchange telecommunications market is so intense that AT&T has no market power. See Comments of MCI, FCC CC Docket 86-421 (March 6, 1987).

The benefits to consumers have been extraordinary. Interexchange rates have declined over 30 percent since divestiture. Consumers have a choice of long distance carriers, and interexchange carriers have developed and are introducing new services that benefit residential customers (e.g., AT&T's "Reach-Out America" and "Call Me" plans); small business customers (e.g., AT&T's "Pro-America" plan); and large customers (e.g., AT&T's Software Defined Network) at breakneck speeds.

The Decree has had the same effect in the telecommunications equipment manufacturing market. As one industry analyst recently remarked, the United States equipment market consists today of AT&T, "a half-dozen towering international firms, . . . plus one to two hundred key smaller firms of diverse heights and architecture," plus literally hundreds of even smaller recent entrants.¹² Indeed, since divestiture, new firms have entered the American market to supply residential telephones, key systems, private branch exchanges, central office switches, and transmission equipment; prices for each of these types of equipment have dropped; and the BOCs are continually establishing relationships with new suppliers. For example, BellSouth has agreed to purchase digital central office equipment from Plessey;

¹⁰ Testimony of Douglas H. Ginsburg concerning S. 2565, The Federal Telecommunications Policy Act of 1986, before Senate Committee on Commerce, Science, and Transportation, p. 4 (September 10, 1986) (hereinafter cited as "Ginsburg Testimony").

¹¹ U.S. Dept. of Commerce, NTIA Trade Report: Assessing The Effects of Changing the AT&T Consent Decree, p. 47 (February 4, 1987) (hereinafter cited as "NTIA Trade Report").

¹² J. Michel Guite, Ph.D., Salomon Brothers, Stock Research on Telecommunications Equipment, the United States Market, p. 11 (February 1987.)

US West is buying similar equipment from Ericsson; and Siemens and other manufacturers have sold this equipment to other BOCs. See *Communications Daily*, p. 5 (April 8, 1987).

"[It has been] estimated that the per-line price of key telephone systems would decrease by 25 percent in 1985 alone, at the same time as technological advances made such systems more versatile than ever before. In the market for telecommunications equipment, the per-line price of certain central office switching equipment has been cut in half." Ginsburg Testimony, p. 4.

Against this background, it is not surprising that consumers have been the most virulent opponents of any modification of the Decree's interexchange and manufacturing injunctions. In the recent proceedings before the Decree Court, representatives of both small customers (e.g., the Consumer Federation of America) and large customers (e.g., the Ad Hoc Telecommunications Users Association and the International Communications Association) have uniformly opposed any relaxation of these injunctions and have made extensive arguments that the Decree's line of business injunctions on the BOCs are essential to consumer welfare.

III. THE COURT'S RECENT DECISION MODIFYING THE DECREE'S LINE OF BUSINESS RESTRICTIONS

In its decision approving the Decree, the Court recognized that technological developments could at some time in the future erode the BOCs' local exchange bottlenecks and obviate the need for some or all of the line of business restrictions in the Decree. See *United States v. AT&T*, 552 F. Supp. at 194-95. Accordingly, the Court directed the Department of Justice to submit a report to the Court every three years concerning the continued need for the line of business injunctions.

On February 2, 1987, the Department submitted its first such report. If proposed that the Court could remove the line of business restrictions that prevented the BOCs from manufacturing telecommunications equipment, providing information services, and entering unrelated nontelecommunications markets. The Department also proposed that the prohibition against the provision of interexchange services by the BOCs could be relaxed to permit the BOCs to provide cellular radio, paging, and other mobile interexchange services.¹³ Thereafter, the BOCs filed motions with the Court seeking the removal of all the Decree's line of business restrictions.

In an opinion issued on September 10, 1987 (hereinafter cited as "September 10 Opinion"), Judge Greene denied these motions in part and granted them in part, holding that two of the four line of business injunctions would be modified.

1. Modification of Noncore Restrictions

The District Court modified the two line of business injunctions that were not at issue in the 1974 Government suit and the other antitrust litigation of the 1970s and 1980s.

First, the Court eliminated entirely the Decree's restrictions on the BOCs' provision of nontelecommunications services. The Court found that the likelihood that the BOCs would leverage their control over the local exchanges to gain an unfair competitive advantage in unrelated nontelecommunications markets was relatively small, whereas the removal of the restriction would eliminate the burdensome waiver process and permit the BOCs freely to participate in these markets without the involvement or supervision of the Court. Nothing that the Court had already granted over 160 waivers of this restriction, the Court concluded that the benefits from its elimination outweighed the danger that the BOCs might engage in improper cross-subsidization of competitive activities. September 10 Opinion, pp. 204-10, 219-20.

Second, the Court held that part of the information services injunction will be removed. The Court noted that the BOCs' exchanges continue to be natural monopolies and that the BOCs therefore continue to possess the ability to use their exchanges to foreclose competition in information services. The Court thus held that antitrust considerations continue to prohibit the BOCs from providing "electronic Yellow Pages" or information "content" in competition with newspapers and other information service providers. The Court concluded that there is no justification for eliminating the information services injunction in its entirety. September 10 Opinion, pp. 105-15, 197-99.

¹³ The Department's February 2, 1987 Report initially proposed that the BOCs should be permitted to provide interexchange services between points outside their regions and should further be authorized to provide in-region interexchange services where entry barriers were eliminated by state regulators. However, the Department withdrew these recommendations on April 27, 1987.

At the same time, the Court was concerned that the BOCs' provision of the "infrastructures" and "gateways" for the information services of others may be an essential condition for the widespread availability in this country of the kind of information services that are becoming available in France, Great Britain, and Japan. The Court rejected the suggestions of the Department of Justice and others that it could not consider these consumer interests in its modification decision, and the Court held that it would modify the Decree to assure the broadcast availability of information services to consumer. September 10 Opinion, pp. 162-67, 201-03.

The court "concluded that the apparently competing interests—prevention of monopolization of information services versus broad availability of such services to the public can be reconciled by severing for decree purposes the generation of information content (which will remain prohibited to the Regional Companies) from the transmission of information services (which the Regional Companies will be allowed to provide)." September 10 Opinion, pp. 221-22. Thus, the Court stated that it will modify the information services injunction to permit the RHCs' to provide the five functions found to be necessary to an information services gateway,¹⁴ and ordered further proceedings (which are now pending) in which the Court will consider the precise modification that it will adopt. September 10 Opinion, pp. 173-203, 220-23.

2. Retention of Core Injunctions

The Court refused to modify the "core restrictions" enjoining the BOCs' provision of interexchange services and manufacture of telecommunications products. The Court's opinion reviewed the events that led up to the trial of the 1974 government case, the evidence introduced by the Department at trial, and the public interest proceedings on the Decree. It reaffirmed that these line of business restrictions were the "necessary counterpart" to the divestiture that occurred on January 1, 1984, and were essential to prevent abuses of the local exchange bottlenecks and to "end over thirty years of strife in the telecommunications industry." September 10 Opinion, pp. 5-21. The Court held that there had been no changes in the BOCs' local exchanges or in the regulation of them that could remotely support modification of these core injunctions.

First, Court held that there was "no basis" in fact for any claim that the BOCs "do not retain their monopoly power over the local bottlenecks." September 10 Opinion, pp. 26, 28. The Court pointed out that the Department of Justice, its expert, Dr. Peter Huber,¹⁵ and almost all the parties and intervenors agreed that the BOCs' local exchange facilities had not lost their monopoly characteristics. The evidence overwhelmingly established, and the Court found, that the local exchanges continue to be a monopoly," that "no substantial competition exists at the present time in the local exchange service," and the large customers and small customers alike are absolutely dependent on the BOCs for exchange access. September 10 Opinion, pp. 26-36. In this regard, the Court found that "bypass" of the BOCs' local exchange bottlenecks has been virtually nonexistent to date. It found that the BOCs' local exchange facilities are used to provide access for "99.9 percent of all interexchange carrier traffic, generated by 99.9999 percent of the nation's telephone customers." September 10 Opinion, p. 35.

In short, the District Court found that local exchange "monopoly bottlenecks continue to exist essentially in unchanged scope and form, and that they continue to provide the same basis for anticompetitive activity as they did prior to the Bell System break-up." September 10 Opinion, p. 45. Accordingly, the Court held that the "core" line of business injunctions against interexchange services and equipment manufacturing remain absolutely necessary to prevent leveraging of local monopolies by the BOCs.

In this regard, the Court rejected each of the arguments that there had been changes in other conditions that could justify elimination of the core restrictions. The Court held that the fact that there are seven Regional Companies, whereas there was only one Bell System "does not constitute a new development;" the Court noted that the fact there would be seven divested companies was a premise of "the very same decree" that imposes the line of business restrictions. September 10

¹⁴ These are: (1) data transmission, (2) address translation, (3) protocol conversion, (4) billing management, and (5) introductory information content.

¹⁵ Although the Department's expert, Dr. Huber, predicted the eventual emergence of a "geodesic" network, the Court pointed out that no such geodesic network presently exists and that such developments "will, if ever, impact the Regional Companies bottleneck control only in the future."

Id., p. 33. Indeed, Dr. Huber's findings on the current state of local exchanges required the Court's holding.

Opinion, p. 55. The Court similarly rejected the arguments that the BOCs' compliance with their "equal access" obligations could be grounds to eliminate the core injunctions. It reasoned that "[i]f equal access had been all that was involved, the decree could have simply mandated the Bell System to provide such access." *Id.*, p. 58.

Finally, the Court rejected arguments that there had been regulatory changes that could justify elimination of the injunctions. The Court emphasized that the Decree was entered because regulation "had simply not been capable of preventing the antitrust problems that the Decree was to resolve" (September 10 Opinion, p. 40), and, indeed, the Decree rests on the findings that such regulatory measures could not "approach even remotely" the effectiveness of structural separation (*see id.*, p. 118), and that regulatory measures had proven "entirely inadequate" to prevent anticompetitive abuses of the local exchange bottlenecks. *Id.*, pp. 116, 150. And the Court found there had been no change in the character of regulation in the three years since divestiture. To the contrary, the Court found that the changes in the past three years consisted of modifying preexisting regulatory requirements to make them *less* stringent. *Id.*, pp. 115-50.

These findings, by themselves, foreclosed any modification of the interexchange injunction. In addition, the Court found that the interexchange market is now vigorously competitive and that opening that market to the BOCs was not necessary to foster interexchange competition. September 10 Opinion, pp. 64-65.¹⁶

With respect to the equipment manufacturing injunction, the Court held that it "mirrors" the "core" injunction on interexchange services. September 10 Opinion, p. 70. The Court found the continuation of the BOCs' local exchange monopolies means that "their incentive and ability to act anticompetitively" and, foreclose competition in equipment manufacturing have not changed, and, indeed, that the exclusion of competitors was certain if this injunction were removed. As the Court stressed: "*The Department of Justice concedes that if the restriction [on equipment manufacturing] were lifted, each of the Regional Companies would satisfy all or nearly all of its equipment needs from its own manufacturing affiliate,*" and independent equipment manufacturers would thereby be foreclosed from a very substantial portion of the equipment market. September 10 Opinion, pp. 82-83 (emphasis in original). The Court concluded, therefore, that removal of the equipment manufacturing injunction "would be likely to extinguish or substantially curtail the healthy competitive domestic market that has emerged in the last three years" and foreclose competition in the design of equipment for the BOCs' exchanges.¹⁷ *Id.*, p. 101.

In refusing to end these two core restrictions, the Court also relied on the fact that in the three years since divestiture, competitors have repeatedly alleged that BOCs have misused their exchanges to engage in discriminatory activities and cross-subsidization in the few competitive markets available to BOCs under the Decree. September 10 Opinion, pp. 151-57. In two of these instances, AT&T was the complainant, and the Decree meant that AT&T was not required to file separate antitrust suits and incur the associated expense and delays of discovery and proving damages, but obtained a swift and certain remedy under the Decree.¹⁸ Conversely, if the Decree's injunctions were modified, these swift remedies would disappear, and the post-divestiture AT&T and the many firms that have entered these markets since divestiture would again be remitted to filing suits, episode-by-episode, in district courts throughout the country and recreating the very burdens on the industry that the Decree sought to end.

In short, Judge Greene's decision to maintain the core line of business injunctions is the only result that can be reconciled with basic antitrust principles and the basis upon which the Decree was held to be in the public interest. However, the Decree's

¹⁶ The Court rejected the Department's suggestion that the interexchange services injunction be lifted with respect to cellular radio, paging, and other mobile telephone services as unworkable and anticompetitive in view of the alleged abuses of the local exchanges by the BOCs already reported in the mobile telephone market. *Id.*, pp. 65-69, 153-54.

¹⁷ The Court's September 10 Opinion assumed that the manufacturing injunction prohibited the BOCs from designing telecommunications products as well as from fabricating them. On December 3, 1987, the Court issued a separate opinion that formally held that equipment design is barred by the Decree.

¹⁸ The Court enjoined one BOC, Pacific Telesis, from refusing to provide essential local facilities that AT&T needed to provide an interexchange public telephone service in competition with Pacific's coin and coinless telephones. *United States v. Western Electric Co.*, 583 F. Supp. 1257 (D.D.C. 1984). Similarly, in 1986, the Court enjoined U S West from seeking to replace the interexchange switching service that AT&T provides to the United States government by offering special low rates for bottleneck access facilities *only if* GSA agreed to obtain these services from U S West. *United States v. Western Electric*, Opinion (November 26, 1986).

line of business injunctions do more than promote competition. They are essential to such vital national interests as promoting foreign trade, preventing balkanization of the national telephone network, preserving reliable, high quality service, and protecting ratepayer interests and universal service. In its September 10 Opinion, the Court found that retention of the core interchange and manufacturing injunctions is necessary to advance each of these objectives.

Foreign Trade.—The Decree was carefully fashioned to assure that AT&T, would not be foreclosed from any portion of the American market and thus be "preserved" as a "dynamic force" capable of competing in national and international markets. *United States v. Western Electric Co.*, 569 F. Supp. 1057, 1120 (D.D.C. 1983). However, as the Court, the Department of Commerce, the Justice Department and Dr. Huber each found, the removal of the injunctions would have created a market structure in which BOCs would have incentives to form joint ventures with established foreign manufacturers, to purchase equipment from these foreign firms exclusively, and to foreclose the only free market in the world to AT&T, America's leading full-line telecommunications equipment manufacturer. September 10 Opinion, pp. 83 n. 135, 86 n.141, 99-101.

The foreign trade consequences would have been devastating. Such a move would simultaneously (1) foreclose American markets to American firms, (2) deny American firms the revenues needed to sustain the research and development needed to sell equipment in Asian, Middle Eastern, and other foreign markets, and (3) give foreign firms captive markets and guaranteed sales in this country. The consequences would be especially severe because Japanese and European manufacturers have, to date, successfully excluded AT&T from Japan, Germany, France, and other European markets. Removal of the injunction would have had the extraordinary consequence that foreign firms would form alliances with the BOCs to exclude AT&T and other American firms from the American market as well.¹⁹

In the September 10 Opinion the Court flatly rejected the arguments of the Department of Justice and others that these consequences are irrelevant to the Court's inquiry. It held that the likely market foreclosure was directly relevant under the antitrust laws (September 10 Opinion, pp. 99-101) and, beyond that, that the "probable deleterious effect of a restriction removal on American foreign trade" has independent relevance in the fashioning of relief in an antitrust case. *Id.*, pp. 172-73.

Prevention of Balkanization.—The Court similarly found that removal of these core line of business injunctions would also threaten the high quality and reliable telephone service that is critical to the nation's businesses, residences, and defense. Specifically, the Justice Department's recommendation to eliminate some or all of the core restrictions would, by its terms, have required severe curtailment of the BOC's joint centralized engineering activities through Bell Communications Research (Bellcore). September 10 Opinion, pp. 90-91. Upon entering the Decree, the Court found that these activities are essential to the "very survival" of the national telecommunications network and that the alternative to Bellcore is "balkanization," "deterioration and fragmentation of the national telephone system," and the transformation of this national resource into a system like Europe's. *United States v. Western Electric Co.*, 569 F. Supp. at 1118.

In rejecting the proposals to eliminate the core restrictions, the Court reiterated these findings in the strongest terms. It held that removal of the core restrictions would be unthinkable when such fragmentation would result:

"Bellcore has responsibility under the decree to prevent the technical fragmentation and hence the deterioration of the national telephone network. . . . To decentralize or otherwise to limit the responsibilities of Bellcore so as to prevent its uses as a vehicle for anticompetitive action by the Regional Companies would inevitably fragment and frustrate Bellcore's centralizing responsibilities which, notwithstanding the divestiture, permit the nation's telecommunications systems to continue to function on the basis of one national network with one national quality standard." September 10 Opinion, pp. 90-91.

Consumer and Ratepayer Benefits.—Finally, the Court found that maintenance of the two core line of business is also essential to protect "ratepayers from . . . overcharges," and to foster a host of other consumer interests. September 10 Opinion, p. 163. The Court reiterated its findings that a BOC that could provide interexchange services or manufacture equipment would have the "ability and the incentive" to cross-subsidize its competitive operations by shifting costs to regulated ratepayers and forcing them to pay "inflated intraenterprise transfer prices" and to

¹⁹ It is for these reasons that the Department of Commerce found in its submission to the Decree Court that the Department's manufacturing recommendation would likely damage foreign trade. See NTIA Trade Report, p. iv.

be overcharged, "perhaps systematically," for essential local telephone services. September 10 Opinion, pp. 165-66. For this and other reasons, consumer groups uniformly opposed to the Department's and the BOC's proposals to eliminate the core injunctions.

In its September 10 Opinion, the Court flatly rejected the arguments of the Department and others that the Court could not consider the adverse consequences that removal of these injunctions would have on consumers. The Court held that the purpose of the antitrust laws "is to protect the consuming public" and that the "objectives of affordable rates and universal service . . . complement the goal of an industry free from anticompetitive action" and require retention of the two core injunctions. *Id.*, pp. 165-66.

For these reasons, AT&T believes that the Decree Court's recent decision reaches the only proper result with respect to the core interexchange and manufacturing injunctions. There is no reason for the Congress to consider further changes in the Decree.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR STEVENS AND THE ANSWERS

Question. What are AT&T's current plans with respect to the implementation of separate billing arrangements for its long distance customers (i.e., by discontinuing use of Bell Operating Company billing and collection services)?

Answer. In June 1987, AT&T began rendering monthly bills to some of its long distance customers in West Virginia. Expansion of this function to the remaining long distance customers will continue for several years.

AT&T currently sends its customers monthly or quarterly bills for the rental or purchase of telephone products and systems. In conjunction with the implementation of its toll billing system, those residence or consumer customers receiving a separate bill for telephone products will receive a single bill for those products and AT&T network services. This combined method of charging will commence in West Virginia this year.

However, some AT&T customer groups may not receive their long distance service bills directly from AT&T depending on certain criteria related to usage levels or technological limitations associated with local exchange carrier (LEC) central office equipment in non-equal access areas. In these instances, AT&T has contracted with most of the major LECs to continue providing billing services through 1991.

Question. What is the timetable for complete implementation?

Answer. AT&T intends to implement billing for its long distance customers by phasing-in its billing operation on a LEC-by-LEC and function-by-function basis through the 1990's. The majority of the conversions will occur in a two- to three-year time frame which will extend at least through 1991.

Question. How many residential and business customers does AT&T plan to bill separately?

Answer. Currently, AT&T is directly billing its business and residence customers for leased equipment, residence customers for some long distance service, and business customers for interstate Private Line and WATS/800 and some intrastate.

AT&T plans to implement over the next several years the additional capability to bill approximately 50 million residential and business customers using AT&T long distance services.

Question. How many residential and business customers does AT&T plan to bill by the end of 1989?

Answer. At the onset of implementing AT&T billing in West Virginia last June, AT&T issued monthly bills for almost 150,000 residence customers. In addition, the billing of 25,000 business customers was part of the effort to bill directly AT&T customers.

As discussed in Item 2, AT&T intends to phase-in its billing operation for long distance customers over a period of time. Since the conversion process requires close coordination with local exchange companies and is anticipated to be gradual, and because customer usage levels and leased equipment usage will partially determine whether a customer will receive an AT&T bill directly, AT&T cannot precisely forecast the number of customers that AT&T will bill during the 1988-1989 period.

Question. What portion of these customers are leased equipment customers who are already being billed separately by AT&T?

Answer. Currently AT&T is directly billing about one-third of its long distance customers for leased equipment.

Senator INOUE. Thank you very much.

We will hear from the panel before we ask questions, if we may. Our next witness is Mr. Levetown.

**STATEMENT OF ROBERT A. LEVETOWN, EXECUTIVE VICE
PRESIDENT AND GENERAL COUNSEL, BELL ATLANTIC**

Mr. LEVETOWN. Thank you, Mr. Chairman.

My name is Robert A. Levetown. I am general counsel of Bell Atlantic.

Bell Atlantic is one of the seven regional telephone companies that is presently barred from competing for most of the long distance traffic in this country, which the companies represented by the gentlemen on my left share among themselves. And they will tell you today just what Mr. Zeglis has told you, that they like the present arrangement very much. I am not going to dispute that.

They will also argue that the present arrangement is consistent with the public interest, and that I am going to dispute. I say there is no competition worthy of the name unless there is price competition, and in the long distance market today, price competition is largely absent.

I realize, of course, that AT&T claims that it has reduced its rates since divestiture and that is true. But it is not true that this price change came about as the result of competition. Rather, it came about as the result of regulation, and it was mainly a price shift, not a true price reduction. Long distance rates came down because costs formerly billed by the telephone companies to the long distance carriers were required by the FCC to be billed directly to customers on their monthly bills. AT&T, being relieved of these charges, was ordered by the FCC to lower its toll rates.

In aggregate, therefore, this was not a price reduction for consumers; it was a wash. Their regular monthly bills went up; their toll charges went down.

When AT&T lowered its toll rates, MCI and Sprint had to lower their rates as well. This is why MCI has said that AT&T's rates should be deregulated. They do not think that a deregulated AT&T with its dominant share of the long distance market is going to cut prices. They think it will raise prices. That will allow MCI and Sprint to raise prices, too, something that Sprint especially needs to allow it to climb out of the red.

Now, this whole scenario will just work out fine, provided the regional telephone companies do not get into the act. We have got the technology and the people to provide long distance services at lower prices, and just as in every other area in which the divested telephone companies have been permitted to compete, we will do so, cutting prices, improving service, and giving the public a better deal.

This is the awful possibility, Mr. Chairman, that these gentlemen are telling you must be avoided at all costs. They say we should be disqualified from competing in the national long distance business because we provide local service. But Sprint's owners, GT&E and United, provide roughly as much local service as the average size Bell regional.

MCI, who is jointly marketing services with its shareholder IBM and with Rohm, IBM's telephone manufacturing division, companies whose revenues are five times as large as the revenues of any regional telephone company, is worried about cross-subsidy, about how we might misallocate costs among our various operations. But our joint costs are allocated by regulatory direction. Theirs are allocated as they themselves see fit.

And then, of course, there is AT&T, the kingpin of long distance traffic in America, owner of the manufacturing empire on which all the regionals depend, more or less, owner of the premier telephone laboratories in the world, the carrier most likely to bypass our local networks whenever it becomes politically feasible to do so. And they are telling you that they are afraid that we might discriminate against them if we could become full fledged long distance companies.

Mr. Chairman, we no more want to discourage AT&T from using our network than does GT&E and United. They have their long distance carrier Sprint, but they also have a profitable business serving AT&T. We, too, would have every incentive to want to serve both our public customers and our common carrier customers well.

In short, there are no public benefits to be gained by continuing to bar the regionals from the national long distance competition. The public benefits in this case, as in most cases in our economy will stem from more competition, not less, and above all, more price competition.

Thank you.

[The statement follows:]

STATEMENT OF ROBERT A. LEVETOWN

My name is Robert A. Levetown. I am Executive Vice President and General Counsel of Bell Atlantic, a company that owns the Bell telephone companies in New Jersey, Delaware, Pennsylvania, West Virginia, Virginia, Maryland and Washington, D.C.

My purpose today is to explain why the AT&T consent decree should no longer be permitted to deny the full benefits of long distance competition to the American people. The regional holding companies are unanimous that the decree's restrictions on providing long distance service must be lifted.

I. THE LONG DISTANCE MARKET NEEDS MORE COMPETITION

Today's long distance market needs more competition. One company—AT&T—has an overwhelming market share. It is estimated that AT&T has approximately 80 percent of the long distance market from which the former Bell telephone companies are prohibited from providing service by the consent decree negotiated by AT&T.

There is also virtually no price competition in this market. Instead, what you see is umbrella pricing.

The questionable state of affairs in the long distance market is best exemplified by MCI's request to the FCC that the FCC deregulate AT&T. MCI obviously anticipates that if AT&T could maintain or increase its prices, free of regulatory oversight, MCI would be able to operate under AT&T's price umbrella. This, however, is not true competition, and offers few real benefits for consumers.

Under conditions of umbrella pricing, if AT&T, the price leader, raises its rates, MCI follows in lock-step. For example, about a year ago, AT&T proposed increases in its prices for several classes of long distance service. MCI, in turn, filed very similar increases in its own prices. When the FCC disallowed AT&T's proposed increases, MCI, in lock-step, rolled back its proposed increases.

AT&T likes to take credit for the reductions in long distance prices which have occurred over the last few years, but those price reductions have nothing to do with

competition. Virtually all of those reductions were simply a pass through of reductions in the price for the access services which the long distance companies purchase from the local telephone companies calls. Even these reductions in long distance rates would not have occurred if the FCC had not intervened and forced AT&T to pass along to its customers these savings in access charges.

This absence of real long distance price competition is apparent in virtually all segments of the long distance market. Several months ago, it became apparent that even the largest long distance customer in the country, the federal government, might not be able to attract a bidder, other than AT&T, for its new long distance network, sometimes called FTS 2000. To make competing bids possible, Judge Greene recently granted what could turn out to be a special exception to allow the Bell telephone companies to offer services as part of that procurement—services which AT&T claimed were prohibited under the decree. There is no reason, of course, why only this project, or the federal government in general, should be the only beneficiary of competition in the interstate private line market.

II. THE FORMER BELL TELEPHONE COMPANIES CAN SUPPLY THE COMPETITION THE LONG DISTANCE MARKET NEEDS

Where is real long distance competition going to come from? Some say that those already in the market, such as MCI and Sprint will provide it, but I think that is quite unlikely. After more than a decade of trying to challenge AT&T, MCI has roughly 10 percent of the market; Sprint has even less and continues to incur enormous financial losses.

What about the other hundreds of long distance companies that AT&T sometimes refers to? These are largely niche competitors, serving limited areas. The modest competitive pressure which they bring to bear is reflected in a recent interview appearing in the trade press of the president of ALC, which bills itself as the "fourth largest" long distance company in the country. ALC has only one percent of the market and acknowledges that it is "a regional player in a niche market" that poses no serious challenge to AT&T.

The former Bell telephone companies, however, can provide that increased competition. They know the long distance business because for years they were intimately involved in it. They have the size, resources, and expertise to offer a real challenge to AT&T.

The competitive "threat" which these companies pose to AT&T is demonstrated by the vigor with which AT&T opposes their entry into the long distance market. AT&T, however, is not entitled to dominate the long distance market in perpetuity.

III. LOCAL TELEPHONE COMPANIES WILL NOT BE ABLE TO DISCRIMINATE AGAINST OTHER LONG DISTANCE COMPANIES

Long distance carriers claim that they can only obtain access to their customers by passing their calls through local telephone networks controlled by the local telephone companies. It is argued that this bottleneck creates a potential for discrimination in providing access to local telephone networks which would become actual discrimination if the telephone companies were authorized to compete for long distance services.

Allegations based on this bottleneck theory were at the heart of the government's antitrust suit against AT&T. The decree, therefore, specifically prohibits the telephone companies from engaging in such discrimination; it also requires that the telephone companies provide "equal access" connections to all long distance carriers. The decree itself, therefore, provides an answer to the long distance carriers' fears.

The premise of this bottleneck theory, moreover, does not apply to many large customers, who generate a very large share of total long distance calls. Such customers have sufficient volumes of long distance calls to make it economically feasible for them to set up direct communications links to their long distance carriers without using the local telephone company network. Indeed, an alternative local telephone company, called Institutional Communications Company, has installed a multi-million dollar network under the streets of Washington to carry calls for these customers, and other such networks are being built in cities all across the country.

AT&T is also getting into the local telephone business. Under a multi-million dollar contract which was recently awarded to AT&T, it will begin providing local and other telephone services to the Treasury Department, replacing services previously provided by the local telephone company.

At a minimum, the telephone companies should be permitted to participate in long distance competition for those customers who have obvious access alternatives.

A much larger volume of long distance service would then be subject to true price competition.

IV. ENTRY INTO THE LONG DISTANCE MARKET WILL NOT DETRACT FROM THE FORMER BELL TELEPHONE COMPANIES' COMMITMENT TO LOCAL SERVICE

Participation by the former Bell telephone companies in the long distance business will not lead to any neglect of the local telephone business or in any way threaten this nation's goal of universal service.

The best proof of this is not what these companies say, but rather, what we have done in the nearly four years since the Bell telephone companies were divested from AT&T. During that period, these companies have been permitted to compete in a number of businesses other than the local telephone business, including the marketing of customer premise equipment, the car telephone business, the yellow pages advertising business, and many others.

While they have been competing in these markets, however, the former Bell telephone companies have continued and increased their commitment to local telephone service. Every year since divestiture, Bell Atlantic has invested approximately \$2 billion to improve its local networks. The other divested companies have invested comparable amounts. As a result, in Bell Atlantic, on-going customer surveys show that the quality of local service is very high.

Nor has universal service suffered in any way. FCC figures confirm that the number and percentage of households with telephone service is at an all-time high. In Bell Atlantic's service areas, more than 95 percent of households have telephone service.

Moreover, local rate increases over the past few years have been quite moderate. Indeed, in several Bell Atlantic jurisdictions, local telephone service rates are lower now than they were in 1984, and local exchange rates are generally going down. In addition, as I will discuss in more detail later, the Bell Atlantic companies are signing up for regulatory reform proposals, which will prevent local rate increases for years to come.

In addition, Bell Atlantic has taken other steps to be sure that basic telephone service remains affordable. It has in place in every one of its jurisdictions a wide range of optional telephone services that can be tailored to meet the calling needs and economic circumstances of almost every consumer. The most economical of these services costs less than \$5.00 per month. Moreover, in cooperation with state and local officials, Bell Atlantic has instituted a number of lifeline plans which are even less expensive.

While my emphasis is understandably on Bell Atlantic's efforts, I can assure you that other former Bell telephone companies have similar rate plans dedicated to keeping customers on their networks.

In short, the experience of the last four years has laid to rest any doubts about the compatibility of competition and universal service.

V. LOCAL SERVICE WILL NOT BE USED TO CROSS-SUBSIDIZE LONG DISTANCE SERVICE

Cross-subsidy theories depend on the existence of rate of return regulation. The notion is that costs of long distance service will be shifted to the local service category. Thereafter, so the argument goes, regulators will unwittingly permit such improperly shifted costs to cause local rates to rise.

If the telephone companies had any intent to cross-subsidize in this fashion, logically they should want to retain the present system of rate of return regulation. In fact, however, they do not.

Bell Atlantic and many other telephone companies are in favor of regulatory reform plans that would give the telephone companies an opportunity to benefit from any improvements in their own efficiency. In return for this opportunity, the telephone companies are willing to freeze basic telephone rates for extended periods. This is not the strategy of companies who intend to cross-subsidize.

Even under the present system of regulation, the FCC has pointed out that local telephone service is an unlikely source of subsidy. Historically, by regulatory design, local rates have been subsidized by long distance service. Service which is priced below cost could hardly fund a cross-subsidy strategy.

No business, moreover, has a rational incentive to engage in cross-subsidy unless there is a realistic expectation that, by subsidizing a product or service, competing suppliers can be driven from the market. After all, the whole idea of a cross-subsidy strategy is to lower prices in a competitive market, drive competitors out of the market and then charge high prices and earn big profits. Because there is no realistic possibility that AT&T can be driven out of the long distance market, there is no

incentive for a telephone company to cross-subsidize its long distance business even if it were assumed that neither the federal nor state regulators would detect such improper cost shifting.

In short, the cross-subsidy theory is shot through with holes, and it is no reason to keep the former Bell telephone companies out of the long distance business.

VI. PERMITTING THE FORMER BELL TELEPHONE COMPANIES INTO THE LONG DISTANCE MARKET DOES NOT VIOLATE AT&T'S DEAL WITH THE GOVERNMENT

AT&T cannot be heard to complain that to allow its divested telephone companies into the long distance business would be unfair to AT&T because it bargained for a consent decree that protects it from such competition. Any such complaint lacks a factual foundation.

When the AT&T consent decree was originally made public, AT&T took no responsibility for the decree's prohibition of its telephone companies providing long distance services. Instead, it told the Congress, the decree court, the FCC and its shareholders that the decree's restrictions on its telephone companies were not its idea. AT&T, therefore, has made it clear that it never bargained for these restrictions; they were simply a windfall to which AT&T has no claim of right.

CONCLUSION

The AT&T consent decree promised that, in exchange for the confusion and uncertainty caused by divestiture, the American public would get the benefits of long distance competition. The American people have paid the price, and it is high time that they received the benefit. If the former Bell telephone companies are permitted to offer long distance service, they can and will deliver the real price competition in long distance service that American consumers deserve.

[The following information was subsequently received for the record:]

QUESTION OF SENATOR PRESSLER AND THE ANSWER

Question. You claim that competition for the local service markets is growing—that there is no longer a bottleneck in this area. How do you justify this claim in view of the testimony that 99.9 percent of all interexchange traffic is still carried by the Regional Companies?

Answer. The BOCs generally hold no monopoly on profitable services.

Even in the local telephone market, services that have been priced with the approval of state regulators to produce attractive profits are frequently subject to significant and growing competition.

This includes "access services" provided by the telephone companies to long distance carriers for their use in completing and originating long distance calls. A discussion of the growing competition for access services was mentioned in my testimony at pages 40-42 of the transcript.

The claim that 99.9% of access services are provided by the telephone companies is based on estimates, made almost two years ago, in a report of a consultant. This report did not reflect the more recent growth in by-pass systems. Moreover, the author of the report suggested that AT&T might be avoiding by-pass for political purposes, rather than as a matter of necessity, in order to maintain "the appearance of dependence on [the BOCs'] services."

AT&T uses the appearance of its dependence on BOC access services in order to bolster its arguments that the BOCs should not be able to compete with it for long distance services. There is very little logic to these arguments, however, in view of the fact that AT&T is just as dependent on access services provided by the GTE and the United Telephone Companies—and yet these companies' corporate parents participate in the long distance market through their joint venture in U.S. Sprint.

Senator INOUE. Thank you very much, sir.

The next witness is Mr. Snedaker, the president of US Sprint.

STATEMENT OF ROBERT SNEDAKER, PRESIDENT, US SPRINT

Mr. SNEDAKER. Mr. Chairman, my name is Robert Snedaker, and I have had the advantage of working for a local exchange carrier, the Bell System, for 22 years, working for AT&T for 2 years; for United Telephone System for about 15 years, which is an independ-

ent local telephone company, and since July 9, for US Sprint. So I have had the opportunity to work in all of the areas that we are covering today.

US Sprint believes that Judge Greene was right, there was a valid reason for prohibiting the regional Bell Companies from entering the interexchange market almost four years ago, and that that reason continues to exist today. Very simply, competitive interexchange carriers like US Sprint have no other means to reach our customers on a ubiquitous basis except through local exchange facilities provided exclusively by the regional Bell Companies. So long as those circumstances exist, the Judge ruled that the BOC's cannot compete in the long distance telephone market. If they did, the possibility of unfair treatment and improper cross-subsidies would be too high.

Please understand, I am not accusing the regional Bell Companies of wanting to engage in anticompetitive activity. I do not think they do. What the judge ruled was that the possibility of such conduct is sufficient justification in keeping the BOC's out of the market under current law. The judge also acknowledged that these circumstances can change, that the economies and/or technology of local exchange service could develop to the point where the BOCs could no longer discriminate against competitors. When this happens, or if the antitrust laws are changed, the BOCs will be allowed to properly enter the market. At that time the results should be beneficial for competition.

Until that time, however, the judge's ruling should be allowed to stand. Competition should be allowed to develop, and the BOCs should instead focus their energies on providing equal and cost-based access to interexchange carriers. Thus, I do not believe there is any need for Congress to consider legislation to alter the judge's ruling at this time.

It would, of course, be appropriate for this subcommittee to continue to monitor the developments in the telecommunications markets, and I hope you take an active role in assuring that the BOCs are not allowed into the market prematurely, and competition develops fully and fairly.

US Sprint looks forward to working with you in that effort toward this ultimate goal.

Thank you very much.

[The statement follows:]

STATEMENT OF ROBERT H. SNEDAKER, JR., PRESIDENT, US SPRINT COMMUNICATIONS Co.

Good morning Mr. Chairman, members of the Committee. I am Robert Snedaker, president of US Sprint Communications Company. I appreciate the opportunity to share US Sprint's views on the continuation of the restrictions placed by the Modification of Final Judgment ("MFJ", "consent decree" or "decree") upon the provision of interexchange services by the Bell Operating Companies ("BOCs").

The nation's third largest and fastest growing long-distance company, US Sprint is very near the completion of the nation's first all digital, all fiber-optic network. Requiring an investment in excess of three billion dollars, the network will span 23,000 miles and reach each of the nation's 186 LATAs when completed. Already over eighty percent of US Sprint's traffic is routed over fiber optics.

As an active participant in the long distance industry, US Sprint has grave concerns regarding the consequences if the BOCs are permitted to provide interexchange services while they continue to enjoy a monopoly over local exchange bottle-

neck facilities. The BOCs' continuing monopoly over local services, including access services, provide them with both the ability and incentive to discriminate against their competitors in the provision of access services or to subsidize their competitive services with monopoly revenues.

For these reasons US Sprint concurs with Judge Greene's recent conclusion that current conditions do not justify removing the MFJ restrictions which prohibit the BOCs from providing interexchange services. At the same time, US Sprint recognizes that the BOCs, with their telecommunications experience and resources, will not be permanently excluded. Once the BOCs no longer possess local monopoly control or when there is no longer a substantial possibility that they could use that monopoly to impede competition, the BOCs should, and ultimately will, be allowed to participate in the interexchange market pursuant to law.

The current restrictions on the provision of interexchange services by the BOCs are a critical element of the consent decree approved by the United States District Court for the District of Columbia to conclude eight years of antitrust litigation between the Department of Justice and the Bell System. During the course of the antitrust proceedings, the Department presented overwhelming evidence of anticompetitive activities by the Bell System resulting from its presence in competitive, or potentially competitive, markets while it simultaneously maintained monopoly power over the local facilities needed by its competitors to reach their prospective customers.

Specifically, the Department demonstrated that the Bell System's monopoly control over the local bottleneck facilities enabled the Bell System to discriminate against its competitors in the provisions of access to those facilities—delaying interconnections, providing inferior connections, or charging exorbitant prices. The Department further demonstrated that the Bell System was able to cross-subsidize its competitive ventures with funds earned from monopoly ratepayers—a practice which allowed the Bell System to engage in price predation. These activities occurred to the detriment of the Bell System's competitors as well as the Bell System's own local customers.

In 1982, after the Department rested its case and Judge Greene denied an AT&T motion for summary judgment, the Bell System proposed a settlement which was accepted by the Department. After some modification following Tunney Act proceedings, the settlement was approved by the Court in the form of the existing consent decree. The goal of the settlement, simply stated, was to prevent both the ability and the incentive for the Bell System to behave in an anticompetitive fashion. The method for attaining this goal was equally straight forward: separate the Bell System's competitive or potentially competitive activities from its natural monopoly businesses. Thus, AT&T, while retaining its competitive Long Lines Division (interexchange) and Western Electric (manufacturing), agreed to divest its local monopoly operations, the Bell Operating Companies.

Integral to the prevention of future occurrence or reoccurrence of anticompetitive behavior by the BOCs through their continuing monopoly over local facilities, line of business restrictions were imposed upon the BOCs to limit their entry into competitive or potentially competitive markets. The interexchange restriction, embodied in Section II (D) of the decree, provides quite simply that:

- [N]o BOC shall, directly or indirectly or through any affiliated enterprise:
1. Provide interexchange telecommunications services . . .

In his September 10, 1987, opinion reviewing the continuing need for the line of business restrictions, Judge Greene described the restrictions as "the necessary counterpart to the divestiture itself." He continued:

That divestiture removed from AT&T its local Operating Companies, the monopoly bottlenecks which had been the means used by the Bell System as a whole to discriminate against its competitors in the other markets in which it was operating (long distance, manufacturing of telecommunications equipment, information services). In turn, the inheritors of the local monopolies—the Regional Companies were prohibited from entering the competitive markets which had been, and could be expected to be again, the beneficiaries of anticompetitive activity by those in control of those monopolies.

The consent decree, however, recognizing that situations may arise which would not require the line of business restrictions to prevent anticompetitive behavior, included a provision Section VIII(C), to remove a restriction upon appropriate showings by the party requesting removal. Section VIII(C), accepted by the Department

and the Bell System as modification to their regional proposed consent decree, provides that:

The restrictions imposed upon the separated BOCs by virtue of Section II(D) shall be removed upon a showing, by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter.

It was in this context that, following the Department of Justice's submission of its "Report and Recommendations Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment," the Court received a number of motions for removal of the line of business restrictions.

The principle reasons for the divestiture of the Bell System and the imposition of line of business restrictions on the BOCs was the Bell System's use of its local monopoly to impede competition in other businesses. That the BOCs continue to possess monopoly power over local exchange facilities is obvious to every residential telephone subscriber in the United States, Mr. Chairman. If you or any other member of this Committee attempted to find an alternative way to connect your home phone, either here or in your home state, to a long distance company—a way which did not require using your local telephone company—you would find that it cannot be done. The simple fact is that virtually all telephone users—residential or business—have no choice but to use local company facilities to originate and terminate long distance calls.

Indeed, the report prepared for the Department of Justice by consultant Peter Huber ("The Geodesic Network: 1987 Report on Competition in the Telephone Industry; hereinafter the "*Huber Report*") found that only one-tenth of one percent of interLATA traffic volume, generated by one customer out of one million, is carried through non-Regional Company facilities to reach an interexchange carrier. The lack of viable alternatives to the use of BOC facilities does not apply to small users alone. Judge Greene's recent opinion noted that "the Department of Justice found only *twenty-four* customers in the entire United States who managed to deliver their interexchange traffic directly to their interexchange carrier, bypassing the Regional Operating Companies" (emphasis added).

Even if claims of substantial bypass were true, the BOCs retain their monopoly over local calling, Mr. Chairman. There is no way for you—like millions of Americans—to call a neighbor without using a local telephone company's facilities. Even the twenty-four bypassers discovered by the Department depend on BOC local networks to carry their local calls. As Judge Greene explained:

The exchange monopoly of the Regional Companies has continued because it is a natural monopoly. Local exchange competition has failed to develop . . . because of the economic and technological infeasibility of alternative distribution technologies.

This continued monopoly over local calling alone presents the BOCs with the ability to act in an anticompetitive manner if allowed into competitive telecommunications ventures. When coupled with their monopoly over access facilities, this ability becomes overwhelming.

With both the ability and the incentive, there are two principle methods by which the BOCs can use their monopoly to impede competition. First, since every long distance carrier must use the local network to originate and terminate calls, the BOC can discriminate against its competitors in the provision of interconnections to the network. By providing itself with superior access, by delaying the provision of interconnections to competitors, or by charging its competitors more for access than it charges itself, a BOC can place competitors at tremendous competitive disadvantage. Each of these forms of discrimination can be very subtly employed, making detection and, therefore regulation, very difficult.

Some have argued that equal access negates the possibility of a BOC favoring itself with superior interconnections. BOC provision of equal access, however, is far from universal. Large portions of BOC territory—some less densely populated areas but considerable metropolitan areas as well—remain unconverted. Moreover, equal access is a target that moves with technology. The provision of equal access today does not mean that the BOCs will share advances in access technology with their competitors in the future.

Similarly, it would be a relatively simple task for a BOC to charge itself less than its competitors for access. The Carrier Access Billing Systems ("CABS") currently employed by the BOCs continually produce bills which include year-old traffic and contain an extraordinary number of errors. With millions of dollars at stake, interexchange carriers are forced to enter into weeks, sometimes months, of arduous au-

ding and negotiating with the BOCs to obtain anything approaching a correct access bill. It is hard to imagine that a BOC would negotiate so forcefully when it sits on both sides of the table.

The second form of anticompetitive potential provided to the BOCs by their local monopolies is the ability to subsidize competitive interexchange services with revenues earned from monopoly ratepayers. Many BOC telecommunications services, local and long distance, will share the same facilities and administrative resources. To accurately establish rates for its services, a BOC must correctly allocate its joint and common costs among its various services. Even a small misallocation to its regulated services can earn millions in excess revenue for a BOC to use in reducing the price of its interexchange services below their actual cost. The BOC can stifle its competition with this form of price predation—at the expense of its local ratepayers.

In a market where price differences among competitors are measured in pennies per minute and participants compete on the basis of quality as much as price, even limited amounts of discrimination or cross-subsidization can have significant negative impact on long distance competition. Already struggling in the face of AT&T market dominance, AT&T's competitors will be forced to contend with BOC anticompetitive conduct as well if the restriction is lifted. Premature BOC entry into the interexchange market could well result in the demise of competition. This possibility is underscored by the tenuous nature of competition in the interexchange business today. Despite significant subscriber growth by AT&T's competitors, interexchange competition remains extremely fragile. The *Huber Report* acknowledged that AT&T has retained a market share ranging from 80 to 97 percent, depending upon whether measured by revenues, customers, or minutes of use. Other than AT&T, facilities-based interexchange carriers and resellers are generally acknowledged to be currently suffering serious financial distress. Under these circumstances, the entry of the BOCs, with all their opportunities for discrimination and cross subsidization, will undoubtedly inflict substantial harm to the prospects for vigorous competition in the interexchange market.

The BOCs should not be forever banned from providing interexchange services however. Obviously, once the BOCs no longer possess a monopoly for local services, the interexchange restrictions should be lifted—the BOCs would no longer possess the inherent ability to act anticompetitively.

Mr. Chairman, that time is not near. Moreover, since the divestiture was the result of the application of federal antitrust laws, the Court should make the determination, based upon record evidence, of when the time is appropriate to remove the decree restrictions. I urge this Committee and the Congress not to take action which could lead to premature BOC entry into the interexchange marketplace.

Thank you.

Senator INOUE. Thank you very much.

The final witness for this panel, Mr. Roberts.

STATEMENT OF BERT C. ROBERTS, PRESIDENT, MCI

Mr. ROBERTS. Thank you, Mr. Chairman.

I certainly endorse the comments made by AT&T. I do not want to reiterate all of their points, but I would like to emphasize a couple points that MCI does feel strongly about.

First, we support the MFJ and we support Judge Greene's recent review and decision with regard to that issue. The ground rules that are established by the MFJ are sound, and they certainly are ground rules that are leading to and will continue to lead to a fully and healthy competitive industry in the long distance segment.

The process is in fact working. It is working simply because the basic bottleneck of control that the Bell Operating Companies have today, that the regional holding companies have today, still exists, and they cannot get into long distance. Should they be able to get into long distance, you will find that this competitive marketplace will simply disappear.

In support of the fact that the process is working, I speak as an MCI executive that has lived through this competitive era. There are many segments of this market that are very competitive, and

all segments are becoming competitive as the regional holding companies and the Bell Operating Co., finally meet their obligations under the MFJ. You can take market segment after market segment where the playing field has been made equal, and you will see that MCI and other competitors have gained substantial market share, upwards of 15 percent in MCI's case, in many areas.

We have put in a significant investment into our network. The industry has put a significant investment into the networks that have evolved around the country under the anticipation that the ground rules put in place by the MFJ will in fact stay in place.

So my point is that competition will continue to move forward market segment by market segment. It is healthy in many of those segments. It will continue to move if these ground rules can stay in place.

The basic reason, in terms of long distance, that the modified final judgment said that the Bell Operating Co., should not be in long distance is their bottleneck control, and there is nothing to say that that bottleneck control of access facilities has gone away at this time, and there is nothing to say that their actions would not be the same as before the MFJ, should things change.

My colleague from Bell Atlantic talked about price competition. He is factually wrong. There has been price competition in this industry. Rates in long distance have gone down, and again, MCI is a case in point. Look at 800 service, for example, for which we recently got interconnections and we are now just starting to compete very heavily against AT&T and other competitors. There we offer a 10 to 15 percent discount below that of AT&T, and a number of customers that have chosen MCI have benefitted because of that.

I think it is somewhat ludicrous that the same people that would criticize the long distance segment of this industry with respect to price competition are the same people that have had outlandish rate increases throughout all jurisdictions on the heels of the modified final judgment and the breakup of the Bell System.

I would finally like to say that what is important to a company like MCI in continuing to push the competitive thrust in this industry is stability of the ground rules. It is critical that we do not have to continue to look at moving targets. It is critical that we do not have to face seven large companies which still control the local bottleneck facilities becoming competitors when things are going well, things are moving in the right direction, and the ground rules are in fact sound.

Thank you.

[The statement follows:]

STATEMENT OF BERT C. ROBERTS, PRESIDENT, MCI COMMUNICATIONS CORP.

Mr. Chairman, the Modified Final Judgement in the AT&T antitrust case has proven its effectiveness in encouraging competition and discouraging anticompetitive practices. In the years since divestiture of the Bell System, MCI and other firms have brought competitive long-distance service to millions of Americans, long-distance prices have fallen more than 30 percent, and hundreds of new entrepreneurial companies have entered the telecommunication equipment and information services markets.

These very real consumer benefits are also, in MCI's view, reason enough for concluding that the safeguards of the MFJ remain just as necessary and valid today as

when the decree was first approved by the Court. In fact, in relation to the long-distance market, the consensus among virtually all members of the industry participating in the triennial review was that the MFJ should not be altered.

As long as the Regional Bell Companies have local monopolies in telephone service, entry into the long-distance business would allow the Regional Companies to use their monopoly power to stifle competition and harm consumers. There really is no question about this. The "Huber Report," prepared for the Justice Department, the Department itself, and the MFJ Court all agreed that the Regional Companies' bottlenecks remain intact.

In its decision reaffirming the MFJ safeguards, the Court summarized the issue very well. The Court noted that the Regional Companies retain power over the local bottlenecks because "99.9 percent of all interexchange traffic, generated by 99.9999 percent of the nation's telephone customers," is carried by the Regional Companies. As the Court concluded, if the MFJ restrictions were removed, "the telecommunications industry would be back where it was before the struggles began. The Regional Companies would have the same incentives, as well as the same means, for discrimination, manipulation, and cross-subsidization that the Bell System possessed before the breakup."

The long-distance business today, after divestiture, is a shining example of how competitive forces, once freed, can provide for America the best that our technology has to offer. While full "equal access" has yet to be achieved, in those areas where equal access is available, consumers now have a choice among scores of national and regional long-distance companies. MCI's own share of the market in equal access areas is almost 15 percent and even higher in some residential and business segments of the market.

New services are being introduced rapidly. MCI now provides international service to more than 50 countries. We will go world-wide next year. Once we were provided with the necessary interconnections, MCI was able to offer the first competitive toll-free service, "MCI 800," with features never before available, in 1987. Starting in 1988, MCI will begin providing operator services, in competition with AT&T, and will introduce "The Global Highway," a package of services allowing efficient, integrated digital international communications.

These accomplishments result from very hard work and a major investment program. MCI and other long-distance firms have invested many billions of dollars in telecommunications networks over the past few years. MCI alone has spent 5 billion dollars, over half of which was committed since divestiture in reliance upon the industry structure established by the MFJ. MCI is ready to invest another \$3 billion in the next five years. With the industry's escape from the litigation jungle of the 1970's—when it seemed we spent more time prosecuting and defending antitrust lawsuits that developing new services for consumers—we've now buckled down to fierce competition. Although there are still some legal issues on which we disagree, the industry today is litigating primarily in the marketplace itself, with the consumer as the judge.

America enjoys extensive competition in the long-distance market only because of the new industry structure created by divestiture and the provisions of the MFJ. All of the evidence shows that changing that structure would threaten these achievements and invite a return to the anticompetitive practices of the past. We would risk the gains of the past few years and reopen the door to cross-subsidization, further increases in local phone rates, and major damage to long-distance competition. As the Justice Department and the Court said in 1984, if we do not understand the events leading up to divestiture and the MFJ, we may be condemned to repeat that history. The industry, and the American public, can't afford to take that needless risk.

We recognize, however, that the rapid advance of technology in the future may require the restrictions of the MFJ to evolve to reflect those developments. In addition, the court has continued to allow the Regional Companies to expand into new business areas where their monopoly control of the local exchange will not create competitive and consumer havoc. The Court recently allowed the Regional Companies to provide "gateway" services for videotex to facilitate information service providers in reaching consumers. MCI is confident that the Court will apply the necessary safeguards of equal access and nondiscrimination to these gateway functions so that competition by the hundreds of current information services firms is stimulated and so that Regional Company information service activities are not cross-subsidized with telephone ratepayer revenues.

The evolution toward a competitive long-distance market must continue, but it needs the support of the federal government and indeed of the Regional Companies so that the MFJ's promise of true competition can become a reality. Before the ink

was dry on the consent decree the Bell companies began their campaign to avoid or remove its obligations. During the last Congress they generated intense political pressure for legislative repeal of the MFJ. They have since litigated, and again lost before Judge Greene in the triennial review, their attempt to attack the factual and legal basis for the decree.

The Administration, nevertheless, appears to have bowed to the Regional Companies' arguments in their endless pursuit, in forum after forum, of the political goal of eliminating the MFJ. The NTIA recently requested the Federal Communications Commission to issue a so-called "public interest" determination which NTIA hopes will abrogate the outstanding antitrust enforcement decree. Just days ago Judge Greene felt compelled to formally question the actions of FCC Chairman Patrick for "exhorting those whom the agency regulates to refuse to comply with orders duly issued by this court." Chairman Patrick had also criticized the Court's exercise of its jurisdiction in enforcing the decree as supplanting the congressional role. The Court responded:

That decree (1) was entered pursuant to a landmark Act of Congress ¹ (Sherman Act, 15 U.S.C. §§ 1-3);² (2) it is the product of a lawsuit brought by one Attorney General of the United States and it was settled, largely upon the terms of the decree presently being enforced, by the authority of a successor Attorney General;³ and (3) it has been explicitly sustained by the Supreme Court of the United States.⁴ In short, the decree here is one of the few judicial judgments to bear the stamp of authority of all three branches of government. Not to enforce it would be irresponsible.

Instead of attempting to circumvent the antitrust policies incorporated in the decree by arguing for its repeal, the Administration and the FCC should focus on regulating access charges, which are the largest single component of long-distance costs. Instead of urging unrestrained Regional Company diversification into long-distance, information services and manufacturing, regulators should concentrate on local telephone subscribers. It is the 40 percent increases in local rates since divestiture which have funded the \$1 billion annual earnings of the Regional Companies and financed their new business ventures. Most importantly, instead of expending their managerial and financial resources in undermining the antitrust decree, the Regional Companies should turn their attention back to the public responsibilities: To the provision of equal access, quality service, fair access tariffs, and a low priced high quality service for the telephone consumer.

The telecommunications industry has been through a major reorganization in the past few years. In the long-distance market and others, competition is redounding to the benefit of all consumers, business and residential. What the industry needs now is a period of structural stability, in which we can continue to concentrate on competition, and federal regulatory policies that support, rather than threaten, the ongoing transition to full competition.

MCI is confident, Mr. Chairman, that after these hearings you will agree that the antitrust principles of the MFJ are working and should be allowed to continue to work—for consumers, for competition, and for American leadership in telecommunications.

Senator INOUE. Thank you very much.

Mr. Levetown has suggested that there is very little competition in the long distance market.

What should be the best measure for competitiveness? We have mentioned price here. What is the measuring stick for competitiveness in the long distance market?

Mr. ROBERTS. If I may answer that, I think competition involves much more than price. That certainly is not the only litmus test.

¹ Because it establishes rules of fair competition for all business enterprises, large and small, the statute is a cornerstone of American public policy, and it has justly been described as a counterpart in the economic arena to the Bill of Rights in the political realm.

² Legislative efforts, both before and after entry of the decree, to exempt telecommunications, directly or indirectly, from the application of the antitrust laws have not seen successful.

³ Information adduced during the AT&T trial indicated that President Reagan rejected requests from the Departments of Commerce and Defense to instruct the Department of Justice to abort the lawsuit.

⁴ *Maryland v. United States*, 460 U.S. 1001 (1983), affirming *United States v. AT&T*, 552 F. Supp. 131 (D.C.C. 1982).

Customers, whether you talk about consumers or the very largest businesses, in any product that they buy, long distance included, are looking for more than price. They are looking for value, they are looking for innovation, they are looking for options, they are looking for features, they are looking for many, many different things, of which pricing certainly could be one component.

Some customers for the particular value or the particular feature that could be bought might be willing to pay more simply to obtain that value or feature. Pricing is not singularly a litmus test on whether things are competitive, but even if that were the litmus test at this point in time, the long distance industry is price competitive, and that is where the benefit has come to consumers and big businesses across the board.

Senator INOUE. Are all of you satisfied that it is competitive?

Mr. LEVETOWN. Of course, we are not satisfied with that, Mr. Chairman. I think the test is what competitive force is driving AT&T's prices down? And the answer is, none. None.

AT&T's prices have been brought down by regulatory direction. When the telephone companies lowered their access charges, the FCC said to AT&T, pass that through to your customers. AT&T resisted that, but the FCC said, "Pass that all through to your customers, not part of it, all of it." Then, in addition to that, the FCC told the AT&T company, "You are exceeding your authorized rate of return. Pass that through to your customers."

But it is nothing that MCI did or that Sprint did that required AT&T to lower its prices.

Now, what I am suggesting is that if the telephone companies could get into this game, there would be the type of forces at work here that would require AT&T to meet the market, to meet a market created by truly competitive forces. That is absent today.

Senator INOUE. Mr. Zeglis, I am certain you would like to say something.

Mr. ZEGLIS. Yes. I have a predictable disagreement with my colleague, Senator.

First of all, it simply is not true that AT&T has ever resisted passing through access reductions of the kind Mr. Levetown is talking about to our customers through lower rates. We have done that and more. And the more is lower prices that my two immediate colleagues here have forced on us through their market pressures.

Senator, since the divestiture date, AT&T has not earned even its authorized rate of return that the FCC allows it under its rate of return regulation. That is not the conduct of a firm that lacks competition and could price anywhere it wants to to earn as high as it wants to. We have fallen below even our authorized rates of return.

To your question, Senator, about what measures would you look at for determining whether we have a competitive market, just let me suggest two. The first is the very dynamic nature of where the market shares are going. And in AT&T's case, it is going down and down and down, at substantial and alarming rates ever since divestiture. We have lost untold customers, millions of customers, really, from our premium, easy access, 1 plus dialing, as the wave of balloting and selecting rolled across the nation, and these two competitors on my right scored heavy gains.

A second dimension that we should not overlook, Senator, and one that always confines competitors, is how much capacity is there, whether or not it is being used. And let me say that our competitors have put so much capacity into their network, particularly into their new fiber networks, that by 1988 it is my understanding that either one of our two major competitors will have enough fiber capacity in the ground to carry all the traffic that traverses the national network on any of our facilities today. Those are very real constraints on our ability ever to move our prices above competitive levels. We just cannot do it.

Senator INOUE. Mr. Snedaker.

Mr. SNEDAKER. Mr. Chairman, I would just like to respectfully disagree with Mr. Levetown regarding the reductions that took place in AT&T's rates. Having been involved in the National Exchange Carriers Association, I would have to observe that the reductions in prices to customers averaged \$1.30 compared to every dollar that was added to the local bill in access charges, and I see a very positive effect with respect to the average customer in that you see massive moves by not only AT&T but the local exchange carriers, the regional Bell Companies, to operate more efficiently at lower cost because of the reductions that are taking place in their work force. And this is of direct benefit to all users in lower prices.

So I see competition as being there. I would have to say that it is a double-edged sword. AT&T certainly is limited in one respect by not exceeding their authorized rate of return, but on the other side, with their size, power, and the fact that they have a very strong place in the marketplace, and were built under regulation, that it would be fairly easy for AT&T to drop prices so low as to drive the new competitors out of business in a very short period of time.

So there is a balance that we have to recognize in order to maintain viable competition.

One other observation I would like to make. Based on the large customers I have talked to, and I would agree with Bert Roberts that the customers see competition, and many customers like to have, large customers particularly, two suppliers for a couple of reasons. One is they can compare features, service, price, and there is another advantage in that they have two sources; in case of a disruption of a network in one location, they have another network to use. And that has happened several times. I know in Phoenix, Arizona there was a major AT&T failure. But the US Sprint network worked. So that you do have those alternatives that are another plus to the constituents.

Senator INOUE. I gather that the administration concurs with the position taken by the Bell Operating Companies and would favor removal of restrictions.

What would be the effect if the Bell Companies participated in the long distance market? Would it enhance or destroy competition?

Mr. ZEGLIS. Senator, could we make a note that I do not think it is correct that the Department of Justice favors removal of the interexchange restriction. It has done some flipping and flopping on this, but when it first came to court in early 1987 it said, remove the restriction for regional companies that start and stop long distance traffic beyond their regions, but keep the restriction for any

traffic that is long distance within their region or that starts or stops within their region, except let them in it as soon as their state commissions lift the lid on exchange competition, local competition, so that we can have real alternatives to access. That was the initial position.

But then, later in the proceeding, the Department withdrew on even that one, and in the end, the motion was not to change the interexchange restriction, at least from the Department of Justice point of view.

As long as I have seized this microphone, I will answer your question, too, if I may take a crack at it.

Mr. Chairman, it seems to me the only thing absolutely guaranteed to happen if you let the regional companies into long distance competition is you bring back dispute, because it is not true, as Mr. Levetown says, that the only reason they have that bottleneck access control is that we find it politically inconvenient to do something about it. They have that control because they are a natural monopoly. They have all of the plant underneath the streets, they have all of the traffic moving around Washington, DC, to the near-in toll points, to the switches that carry the traffic on up to the three carriers represented here. They have plant and technology which, when you combine it with their volume, makes them the lowest cost producer for that access service, that last mile that we all need to get to our customers, anywhere in the world.

It is simply not the case that we can go in and bypass and become competitive at any time. So they do have that lock on the access, the last mile of the traffic, that would bring back the controversy if they were to come into the business, guaranteed. History here is very telling because we had a bottleneck then and we have a bottleneck now.

On the other side, what would they bring to the market? Well, if they brought something new and unique because they could combine somehow long distance service with special technology or special positions due to their local exchange, or get customers because they also ran the local exchange, that would violate the number one fundamental principle, that you are not supposed to use that local exchange to do something in the long distance market that those of us who do not have local exchanges cannot do.

So you could not bring anything to the market in that respect without violating the cardinal rule.

And then if you say, all right, nothing coming to the market because of the local exchange, all you have is one more competitor among 560 who have fairly low barriers to entry right now, lots of capital and lots of opportunity to get in there.

So I do not see it as enhancing genuine competition, and I do see it as bringing back those disputes, Senator.

Excuse me.

Senator INOUE. Do you concur with that?

Mr. SNEDAKER. Mr. Chairman, I think, one, I have a little trouble when we describe the market as 560 competitors working out there. There are a lot of resellers that will get fewer and fewer in number in my opinion. And one of the questions would be, in looking at this question, as to on what basis, if the RBOCs were permitted to return to the interstate, interLATA business, would they be per-

mitted—first of all we have to recognize they are in the intraLATA business, which is 17 percent of the total market in the United States today. They have a bigger market share, two and a half times that of U.S. Sprint, and a slightly smaller times MCI.

So we have to recognize that the regional Bell Companies are in fact in the long distance business today. Any call within the State of Connecticut, for example, you are getting into an intraLATA call where the local telephone company is in the business.

One question as we go down the road into the future is would this be on a facility-based basis or on a resale basis, meaning a regional Bell Company, if it were permitted to build facilities within its entire region and hook those facilities up with the region next to it, that you would recreate the old Bell System, only you could call it the RBOC system, and the capacity levels would be tremendous because I do not know if—I was surprised to hear John's estimate of the capacity of the fiber in the ground, although I would admit that the new technology is rapidly increasing that capacity, I do not think any regional Bell Company would plan to build a nationwide network, and I do not think that it would make sense to have them come in on a facility-based basis.

So the real question gets back into the relationship, the market power, and how they tie in to the local customer base. And at this stage I would have to say that I do not think it would help competition to do that at this time.

Senator INOUE. I have many other questions, but I would like to call upon my colleagues at this time.

Senator McCain?

Senator McCAIN. Thank you, Mr. Chairman.

It seems that we have a strong difference of opinion here. I think it might help this committee if we somehow had a resolution, either through presentation of facts to back up the argument or perhaps more objective observers.

But Mr. Levetown, you claim in your statement, you say rather candidly, I guess, there is also virtually no price competition in this market, period. And yet Mr. Roberts states in his that long distance prices have fallen more than 30 percent, there is indeed price competition throughout the market, on and on.

How do we reconcile this obviously strong difference of opinion here?

Mr. LEVETOWN. Well I have tried to explain that the 30 percent cut is not a price reduction but a price shift. These are charges that were formerly billed in the form of toll rates. Now customers get them in the form of monthly charges on their regular bills.

So what we are doing is moving the cost from one pocket to another. This is not a price reduction.

I see this as a situation where AT&T calls the tune as far as prices, and when AT&T raises its prices, MCI and Sprint can raise theirs. When it lowers its prices, they have to lower theirs as well. But there is nobody giving AT&T the type of price competition that makes AT&T respond to a competitive thrust. That is the defect in this market.

That is why Mr. Snedaker says that AT&T still could drive the new competitors out of the business. It could still do that. But if the regional companies were in this, it would not be so easy. These

would be a real competitive force that AT&T would have to contend with, both pricewise and in every other way.

Mr. ROBERTS. I think to some degree it is a bit narrow or unfair, if you will, to focus solely on price competition, but in direct answer to what was said here, there simply is price competition in the long distance industry. There has been study after study which could be submitted to this committee that will demonstrate that pricing in long distance has gone down to the benefit of the consumer, while local rates have gone up, and local rates have gone up disproportionate, disproportionate to the subsidy movement of the cost shift, as Bell Atlantic indicated, from one pocket to the other.

To be in business, to compete, MCI must, as a basic criterion, offer price competition to the customers that it tries to market to. I think we would have a very difficult time going to a large user of 800 service, for example, and be able to get that customer to try MCI's 800 service which we now offer without, among other things, being able to indicate to that customer that he will save money.

Without going into the detail, AT&T's price responses to some of the FCC's requirements have clearly been targeted, if you will, toward competitive markets. AT&T, for example, has lowered their international rates and lowered them, I presume, because MCI was becoming very competitive in certain of the international markets.

It is almost beyond comprehension to say that MCI does not have to compete in this marketplace on a price competitive basis to be able to obtain market share and to win business. There is price competition in the long distance segment.

Senator McCAIN. Have you, as Mr. Levetown charges, raised, you and Mr. Snedaker, raised and lowered your rates in response to AT&T raising or lowering of rates?

Mr. ROBERTS. During the last two years we have only seen in the long distance business lowering of rates. I cannot think of any particular instance over the last couple years since divestiture where rates in fact were increased in the basic market segments.

There are, however, new services coming on line which are not as easily compared on an apples-to-apples basis, where price competition has to be judged with value: MCI's electronic mail service, for example, in competition to both the one offered by Sprint and the one offered by AT&T. I think you will find where there are like services it has been very price competitive. Where there are value-added portions of those services, we were able to price differently depending on those values. But again, price was an ingredient.

Mr. SNEDAKER. Senator McCain, I think there are two things we have to look at. One, for a company like US Sprint to gain market share, one of the things we have to do is price below AT&T, to gain market share. If we were in a steady state position where we were satisfied with our share of the market, AT&T was satisfied with its share of the market, then presumably we would keep our prices roughly at the same level and move them at the same time.

Now, our prices are lower than AT&T's, and every time AT&T lowers their price, for whatever reason, we will lower ours to continue to gain market share until we have a critical mass large enough to operate efficiently enough to very effectively compete with MCI and AT&T.

Senator McCAIN. Would you agree, Mr. Snedaker, with Mr. Levetown's allegation that you really do not pose any competition for AT&T since they control 80 percent of the market?

Mr. SNEDAKER. No, I would not agree with that, and the reason that I do not is that we are in the process obviously of growing our market share, as well as MCI is doing, so that this is a process because of the size of the market and the fact the market is growing itself—

Senator McCAIN. But he claims that you are in financial trouble.

Mr. SNEDAKER. When you start a business as large as US Sprint, in order to build a 23,000 mile network, invest over \$3 billion and build the sales force up to 13,000, you do expect to lose money in the early stages. It is not our goal nor our projection to lose money going forward, and Mr. Brophy projected in the newspapers that he expected US Sprint to be in the black by the fourth quarter of next year or the first quarter of the following year.

So that is where we stand.

Mr. ZEGGLIS. Senator, if we could raise our rates as freely as Mr. Levetown says, we would earn what the Commission lets us earn, and yet we do not. We fall short of that. And the reason is that if we raise our rates, these people take our business away.

Let me suggest, too, Senator, that when we talk about market share—and there are a lot of different estimates out there, 60, 70, 80 percent—that does not tell the whole story. I mentioned the movement of market shares, but the other thing to keep in mind is that we have 100 percent of plenty of markets nobody wants, the kinds of markets where the rural customer or the customer in other sparsely settled areas of the country have AT&T service, but they are not particularly profitable, and it does not attract our competition.

In the lucrative markets, the business markets, or in some states where only local or regional customers set up, our market share goes way down. In Texas, in the golden triangle, we have a market share of less than 50 percent among the major cities of the Texas golden triangle. So even a market share analysis, when you aggregate all the submarkets, is misleading and overstates our position.

Mr. LEVETOWN. Senator—

Senator McCAIN. I am enjoying this debate.

Mr. LEVETOWN. If AT&T has some markets that nobody wants, we will take them, and we will give them some competition in those markets that they have 100 percent of if we are given an opportunity to do so.

We are already there in these rural areas. We are already there in these sparsely populated areas, and there is no reason why those people should not enjoy the benefits of competition, too.

Now, Mr. Zeglis says that they cannot increase their rates because of this terrible competition, but the fact of the matter is they are proposing a rate increase right now. They are proposing a rate increase currently on file with the FCC for night, evening and weekend rates. That is right there before the FCC for consideration right now, even though access charges charged to them by the local telephone companies are going down.

So I really do not think it is true that AT&T is under competitive pressure and cannot raise its rates.

Mr. ROBERTS. If I may just speak to one point, I do not want to leave this committee with any idea, either because AT&T said it or Bell Atlantic endorsed it, that there are markets that nobody wants, meaning Sprint and MCI. That in fact is not the case. You will find, again dealing in fact, that many of the markets where we have not yet been able to get into and offer competition exist simply because the Bell Operating Co.'s, and in many cases, the independent companies, have not converted their offices to equal access. That certainly is not exclusively targeted at rural areas. NYNEX, for example, has only converted 60 percent of their offices to equal access.

MCI's network is extending. Today we are in something like 95 percent of all the serving LATA's. I believe Sprint's network is also extending, and our targets are to serve all LATA's. The network is extending.

But the burden of nonservice is on the back of the local exchange carriers who have not yet made equal access equal in many of these areas.

Senator McCAIN. Mr. Chairman, I think we have obviously got a very sharp difference of opinion on this issue, to say the least. I would hope that the witnesses would be able to provide this committee with some studies which perhaps would give us some more factual substantiation to back up their arguments because I think we are really talking about whether the Bell Operating Co. should be allowed back in or not, and that judgment must be made on the facts. And we have two different sets of facts here.

So I, Mr. Chairman, would request that I might be allowed to submit written questions for the record, and I hope that our witnesses will provide us with that information so this committee can make a better judgment.

Thank you, Mr. Chairman.

Senator INOUE. I can assure you of that.

Senator Kerry?

Senator KERRY. Thank you, Mr. Chairman.

I would like to ask, to begin with, Mr. Roberts, Mr. Snedaker, and Mr. Zeglis, if you could sort of restate for me what at least your understanding of the underlying rationale for the long distance line of business restriction is as stated under the Modified Final Judgment. What is the underlying rationale from your perspective, just in simple terms?

Mr. ZEGLIS. The underlying rationale is that in order to compete in the long distance market, competitors must absolutely have the use of the local exchange facilities to reach their customers. The finding by the Department of Justice and the court and the special consultant were that we all use the local company facilities 99.9999 percent of the time to reach our customers.

Leading up to the decree, the divestiture and the restriction was a history of dispute as to whether when one business operated both the long distance and the local exchange networks there could be fair competition. The only way out of the dispute was to make that very clean, functional split that solved this problem of integration in a way that regulation and other kinds of judicial decrees could not, and that was spin off the monopolies and confine them from building back into those competitive long distance markets.

Senator KERRY. OK.

Now, given that, I take it, Mr. Roberts and Mr. Snedaker, you agree with that.

Mr. ROBERTS. I do.

Senator KERRY. Mr. Levetown, do you have any disagreement with that statement of the underlying rationale?

Mr. LEVETOWN. I think that is an accurate statement of the rationale, but I think that the rationale, in fact, is actually incorrect.

Senator KERRY. OK.

Well, then, let me come back to that afterwards. Let me continue here.

From your perspective, factually, has anything changed, or what has changed potentially since divestiture that might lend support to undermine or change that stated rationale? Anything?

Mr. ZEGLIS. Senator, I do not believe so. The purported changes are not changes at all. We knew at divestiture we would have seven regional companies, but each in its own backyard would have that stranglehold on the competitive long distance access. We knew we would have equal access. It was written into the decree and in the provision of this Senate's bills. We knew we would have regulation because we had it then.

The one overriding, devastating fact that did not change between divestiture and the judge's September 10 opinion was the presence of a local monopoly which carried that 99.999 percent of our access traffic.

Senator KERRY. Mr. Roberts or Mr. Snedaker?

Mr. ROBERTS. I agree with that. Nothing in terms of the basic premise that you are pursuing has changed with respect to that local bottleneck and what was in the MFJ.

Mr. SNEDAKER. I agree also, Senator.

Senator KERRY. Now, in your opinion, was the interexchange issue—let me see how to phrase this in a way that is not sort of an obvious answer, but does a fair reading of the stated judgment lend credence to the notion that the interexchange issue was not a close case in the triennial review process?

Is it fair to say that from your judgment?

Mr. ZEGLIS. In my judgment, in my view of the issues, Senator, it was not close.

Mr. ROBERTS. With the exception of the turnaround and then turnaround again of the Department of Justice prior to hearing of the case, I do not think it was close. It was nearly unanimous as it relates to the respondents on the issue. I think the fundamental Huber Report and other parties and studies addressing the local exchange market and the question of whether it was still a monopoly were very clear as to that fact.

Senator KERRY. All right.

Mr. Levetown, let me now come to you and ask you if you would state without disagreeing with the rationale, for the moment, without sort of relitigating the divestiture issue in a sense, what in your judgment has changed, what is different, what is there that should not open us up to a consideration factually?

Mr. LEVETOWN. All right. I think one thing that has changed since divestiture is that we, the Bell Co., have spent hundreds of

millions of dollars to re-engineer our networks to give the interexchange carriers equal access to our networks.

Now, Mr. Roberts cited a figure of some 60 percent complete in NYNEX, and I do not have the NYNEX figures. I have the Bell Atlantic figures. We are 90 percent converted as of now to equal access. By the end of next year we will be 97 percent converted.

That is a change, and it represents an enormous amount of effort and an enormous amount of money.

Senator KERRY. But that provides access.

Mr. LEVETOWN. That is right. It provides equality of access.

Senator KERRY. All right.

Mr. LEVETOWN. Now, the second thing—there is something that has not changed, and that is something we have been talking about this morning, and that is the continued domination of AT&T in this market. I think that is a factor.

But let me get back to the issue of is there competition for access service, the service that Mr. Zeglis says the interexchange carriers must have to complete their calls.

Well, in fact, there is competition for access service. There are people building fiber networks in all the major metropolitan areas to provide access to long distance carriers, to completely bypass our networks.

I cited an example of this in the written testimony. There is an outfit called ICC that is building a fiber network in the Washington metropolitan area that begins in Rockville, goes to the heart of downtown Washington, and then goes out to Tysons Corner. AT&T recently won a bid for service to the Treasury that displaced 23,000 access lines of the C&P Telephone Co. This is like a small town. But those are not small town lines. These are lines that pump out an enormous volume of very profitable long distance and access traffic. This is all being picked up by AT&T who provides the switch and ICC, who provides the local access.

This is an extraordinary example of bypass right in Washington, DC, and it is repeated many times in other cities. These facilities are being built, and it is an enormous change.

Furthermore, I would point out that although AT&T has told the Congress and told the court that bypass is not much of a possibility, they have told the state commissions exactly the opposite. In case after case they have said that bypass is real, it is a present danger, and because of that the commissions should require the telephone companies to lower their access charges.

In addition to that, AT&T is actively marketing bypass systems to their large customers, private microwave systems. They are telling their customers that they will be able to recover their costs within a year or less from these microwave systems. AT&T is also restructuring its interstate rates to facilitate bypass.

So these are changes, very significant changes, which indicate that there is an enormous potential and an actuality of competition for access in the local market.

Senator KERRY. If somehow there were to be a modification which permitted you entry, why would you not then have simply recreated the vertical monopoly structure which gave rise to the Justice Department suit and other lawsuits?

Mr. LEVETOWN. Well, we do have the problem that we are split up seven ways. So there is no way we can put Humpty Dumpty back together again. And furthermore, we have a very significant competitor in the form of AT&T. I mean, AT&T is not going to let us get away with the type of abuses that were charged against AT&T.

Senator KERRY. Would you comment, Mr. Zeglis, on that?

Mr. ZEGLIS. On the whole speech?

Senator KERRY. On the Humpty Dumpty—well, no, on the Humpty Dumpty ability and the vertical monopoly issue.

Mr. ZEGLIS. Well, I suppose the other side of the coin to relieving the restrictions on the operating companies, moving back to long distance is to relieve the restriction on AT&T to reacquire operating companies which I use not because it is a real threat, but just as an illustration of how futile it would have been to put the nation through this kind of wrenching experience only to let vertical integration reappear by whatever form.

This access competition, Senator, if I could just take a moment on the things that AT&T is not doing, first of all, none of us can ever avoid the local companies' switches. The kind of access competition we are talking about here, and it is tiny, is a pipe that does not go through the switch, that makes a direct connection from a customer's business to an interexchange carrier switch. Even the very largest customers we have, found the court, always go through the switch for half or more of their traffic.

Secondly, AT&T does not have a bypass policy. AT&T goes to the local company first. We know a lot about that business and we know that they have the lowest costs. We also know that sometimes they are pricing those services in multiples above their costs, and when the prices come down on the costs, they will be very competitive. They will be the low priced supplier. And access suppliers in alternate forms will have a very tough time if they can make it at all.

The department's consultant found six cases of this kind of bypass. It probably measures in the two dozen. We do it not because we want to bypass but because when our customer comes and tells us it is either pick another access mode or we are going to MCI or Sprint, we say, all right, we will do it the other way.

It happened at Merrill Lynch. They said take Teleport, which is their 95 percent owned subsidiary there in Manhattan, and of course, we signed up for that rather than lose the customer.

Senator KERRY. I know that we are not operating on the clock here, and I see two more of my colleagues have arrived, Mr. Chairman.

I thank the Chair.

Senator INOUE. Thank you very much.

Senator Danforth.

Senator DANFORTH. Mr. Chairman, thank you.

Gentlemen, I take it this is an oversight hearing.

Are you proposing legislation? Do any of you want us to do anything?

Mr. ROBERTS. MCI is definitely not proposing legislation.

Senator DANFORTH. How about you, Mr. Levettown?

Mr. LEVETOWN. We have no bill in being.

Senator DANFORTH. Can we all leave, then?

Mr. LEVETOWN. I am here at your invitation.

Senator DANFORTH. Thank you very much.

Some people feel that if the operating companies were to be in the long distance business, it would put us back to where we were before divestiture except that there would be seven Bell Systems of the old sort.

Is that a fair statement? Do you agree with that, Mr. Levetown?

Mr. LEVETOWN. Well, the statement which I have heard made before, as well, seems to me to be self-contradictory. The Bell System was a unique institution. It was an institution that was nationwide in scope. The size and the assets and the power of that institution is simply not comparable to any of the regional companies.

Furthermore, there is still AT&T out there. AT&T is three times as large as any of the regionals. So we have a potential here for enormous competition within the entities that used to be the Bell System, and I do not think that the public is getting the benefit of that potential competition. That is our position basically.

In other areas in which we have been permitted to compete, that is, in the provision of Yellow Pages advertising and directories, in the sale of telephone equipment, in the sale of cellular service, we have not coalesced into one Bell System. We have competed with each other, and we have brought down prices and we have improved service. We should be able to do that across the board.

Senator DANFORTH. Are you satisfied by that, Mr. Roberts?

Mr. ROBERTS. No, I am not. I think it is a very good analogy that it would be analogous to putting the system in a way back together again. As long as Bell Atlantic controls the facilities that a company like MCI would need to get access to the customer, they in effect will control the destiny of that customer. Competition as it is evolving today with companies like Sprint, MCI, a large number of resellers, a number of regional fiber carriers interconnecting together, would simply cease to exist.

If you recall the answer to the last couple of questions by my colleague from Bell Atlantic, it ceased to exist in his answer. He talked about seven companies competing with AT&T.

This market will become very competitive and evolve to a very healthy, flourishing market if we let the status quo proceed.

Senator DANFORTH. Mr. Snedaker?

Mr. SNEDAKER. Senator Danforth, one question I would have, if the seven regional companies were to be permitted back into long distance business would be how that might happen, and if the seven decided to combine and connect their networks, you would in effect go back to square zero and recreate what was the Bell System before.

Another factor that I think is very important is that even on a regional basis, if they were not permitted to carry traffic outside their regions, the amount of traffic within each region is very large. In fact, today the regional Bell Companies have exclusive, for all intents and purposes, use of the intraLATA long distance business, and that alone represents 17 percent of the total marketplace.

So I guess my answer would be that with the competition we have today, even though there is very strong competition and AT&T has a very large part of the market and they are very strong, that to permit the companies that control the bottleneck facilities that all of us in the interexchange business are dependent upon, would not enhance competition.

Senator DANFORTH. Mr. Zeglis.

Mr. ZEGGLIS. Senator, I agree. It is a step backwards to the old problems. The fact that we split the exchanges seven ways does not diminish their power where they exist, and probably two steps backwards because we would be part of the fray, and we really do not want to become an antitrust plaintiff.

Senator DANFORTH. In the event that the Bell Operating Co. were allowed in the long distance business, what would be the future of US Sprint and MCI?

Mr. Levetown, what do you think?

Mr. LEVETOWN. Frankly, Senator Danforth, I do not know what the future of Sprint, particularly, is even if we do not get back into the long distance business. They have been incurring enormous losses, over half a billion dollars this current year.

I really cannot predict what the future would be for either of these companies, but I have to say this, that the public interest here is not served by protecting competitors. It is furthered by protecting competition. And I do not think that by eliminating from the competition the potentially most efficient competitors is the way that public policy ought to be made.

And that is the present policy that we are now dealing with.

Senator DANFORTH. Mr. Roberts?

Mr. ROBERTS. The effect on MCI would be dismal at best case, and catastrophic, I suppose, at worst.

I have a hard time envisioning if the process would change this early in the game, if the ground rules would be so fundamentally and structurally altered, I have a hard time envisioning how MCI could continue to grow and continue to penetrate market if we had to compete against the people that controlled the bottlenecks and the access facilities that we required.

Mr. SNEDAKER. Senator Danforth, I think it would be, even though I do not agree with Mr. Levetown's dire predictions for US Sprint, we are moving in the right direction. We do think we will be successful. We do think we have a state-of-the-art network, the only 100 percent fiber optic digital network. It is the technology of the future. It does have tremendous capacity.

And to permit regional Bell Companies with their very large cash flows to build duplicate facilities, to build on what they already have in place in the way of fiber optics by enhancing the capacity through electronics would do two things. One, it could produce a glut of capacity that would not be beneficial to anyone. And secondly, at this stage, I think the key goes back to the close control that the major, all the regional Bell Companies have of the bottleneck facilities, the local loop, and the close tie-in that they have, that to permit them in at this time would have a very negative effect on a company like US Sprint.

Senator DANFORTH. Mr. Zeglis?

Mr. ZEGGLIS. I will not predict their future. We worry a great deal about the way they take our customers.

Senator DANFORTH. About what?

Mr. ZEGGLIS. About how they take our customers away if we try to raise our rates or are not Johnny on the spot with the new services and the good quality responses. We consider them very potent competitors.

Senator DANFORTH. Would you continue to worry about them as competitors if the operating companies got in long distance?

Mr. ZEGGLIS. They have substantial networks with lots of capacity. Yes, that is a severe constraint on what we could do.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator INOUE. Senator Stevens?

Senator STEVENS. Mr. Chairman, I congratulate you on having these hearings. I am sad at the fact that I have just received a note saying Secretary Shultz has summoned some of us to come for a briefing on the summit, so I will be very brief.

First, let me tell my friend Mr. Zeglis that I have some questions. One of my tasks here has been to sort of try to help the Postal Service survive, and I am a little bit worried about some of the aspects of recent changes in AT&T's billing arrangements as they affect the survival of the Postal Service.

So I hope you will not mind if I just submit those questions to you rather than take our time now to read them, and to have your response.

Mr. ZEGGLIS. I would be happy to respond, Senator.

Senator STEVENS. The other thing, I would like to ask just two general questions to all of you. Having been an attorney now for some years, too many to put on the television, I am a little worried about what we are doing here. I see that, you know, we have lived through the concept of the consent decree modification, of Judge Greene's continued retention of jurisdiction, a hearing to bring about a modification of a consent decree on a disputed basis, which is the first time I have ever heard of that. And then I see that Judge Greene is taking potshots at the FCC and in effect telling them to keep their hands off of consultation with members of the industry.

I have some serious worries about this situation. My first question is, do you think it is right for one man to determine the future of the telecommunications industry in the United States?

Mr. LEVETOWN. I would be glad to answer that.

Mr. ZEGGLIS. So would I.

Mr. LEVETOWN. Obviously, I think it is not. However, in defense of Judge Greene, I think Judge Greene feels that the burden and the responsibility has been thrust upon him because Congress, as he frequently points out, has never acted to take policy in hand.

Senator STEVENS. I would agree with that concept about Judge Greene, but none of you are recommending that we do anything about it.

Mr. ROBERTS. Senator, from my perspective, from MCI's perspective, what Judge Greene is doing, he is basically providing jurisdiction over the antitrust laws. What led to the MFJ was a long trial where there were antitrust violations. There was an agreement, a

consent agreement that was put in place, and he is presiding over that agreement.

I do not believe he is providing telecommunications policy. There was an Antitrust Act that was passed by this Congress. Basically, it gave the courts jurisdiction in certain cases, and I think his focus is on that particular issue, particular area of enforcement of the Modified Final Judgment and not trying to dictate telecommunications policy.

Mr. ZEGLIS. Senator, could I jump in long enough to agree with Mr. Roberts that Judge Greene is doing his job in enforcing an antitrust decree, but does not deny, and in fact believes, and I think we all believe that there is room here for both a Sherman Act decree and the Communications Act. In fact, the FCC thinks that, too, because when they were asked in the 1970s do you have preemptive jurisdiction, they said no. When we got to the decree and the public interest hearings in 1982, the FCC came down and participated and told the judge very clearly there are some matters of potential conflict between a decree and the Communications Act, and they listed them.

They were license transfers, physical interconnections, the level, structure and costing of access rates. They said those are potential conflicts that we have to watch out for.

And they moved on and said, now, on these line of business restrictions, that is not likely to conflict. We do not agree with them. We do not think it is good public policy. But we are not claiming a conflict, and we are here to go on and tell you our view of a good public policy under the Antitrust Act.

But that dichotomy was stated, and I think it has been observed by both the Commission and the court. Judge Greene has granted long waivers for the FCC to undertake its tariff review process long after the access charges should have become effective under the decree, in an accommodation of those critical FCC interests, and the FCC on these line of business restrictions, has not created a conflict or claimed a conflict. They have participated as *amicus curiae* in the repeated examinations of these decrees.

And I think it is a very good example of two jurisdictions accommodating one another, for each to pursue its essential interests.

Senator STEVENS. Well, I do not have the time to go into my comments about the recent action of Judge Greene, but it does seem to me that we have come to the point now where we have gone beyond the modification of an antitrust consent decree. What we are really talking about in the future development of telecommunications and who is going to be allowed to grow and who is going to be forced to stay in a straitjacket. That, to me, is not antitrust policy, an antitrust consent decree modification; that is telecommunications policy. And it is time, I think, that the Congress address that, because the tumbling technology that we see in your industry is so volatile that I do not think that we can depend upon one man to make the decisions that will lead to the wisdom that we maintain the lead we have had in the past into the 21st century.

My second question to all of you is, What do we do if something happens to Judge Greene?

Can any Federal judge make this decision that he has been making?

Mr. ZEGLIS. Well, the decree, Senator, is a decree of the Federal courts, the Federal judiciary, and the next judge assigned the case, I presume, would enforce the decree and continue whatever appropriate proceedings toward enforcement would be necessary.

Senator STEVENS. Well, as I understand, Judge Greene has indicated that he believes that Mr. Patrick has counseled members of the industry to defy a court order, when in reality he has been pursuing the authority that was given to him by the Congress.

That disturbs me a little bit. I mean, that thing alone, that concept alone that came out of this last action leads me to believe he does believe he has further control that goes beyond antitrust determination.

And I think we should expand the hearings, Mr. Chairman, not contract them, and I would believe we ought to be dealing with the prospect of modification of the Communications Act. Sometime before the end of this century we had better do that, or we will be in real chaos after the beginning of the next one.

I am sorry, gentlemen, I have to go.

Senator INOUE. I can assure you that this subcommittee intends to do exactly that. We will be continuing these hearings early next year, to listen to all of the many witnesses, I am certain, who would like to appear before us.

We have a vote pending at this time, but Senator Exon would like to ask one question before we go.

Senator EXON. Thank you, Mr. Chairman.

I congratulate you for calling this hearing, and I apologize to the witnesses. I have been tied up on the floor all day and am going to be on the matter before us over there.

I just have one question because of the pressures of time, and I think I know where Mr. Zeglis and Mr. Levetown stand on this, so I will address the question to Mr. Roberts and Mr. Snedaker.

How do your organizations feel, and what stand have you taken, if anything, with regard to the Bells getting into the manufacturing and the inventing of new types of communications systems? Are you for or against that?

Mr. ROBERTS. Our position on the Bell Operating Co., regional holding companies, getting into manufacturing is that we are against it. We are against it because we believe—we do not manufacture, but we buy from a myriad of vendors, and we buy a lot of very current and state-of-the-art technology. We are concerned that should the Bell Operating Co., get into the business of manufacturing, some of these young research firms, young manufacturing firms making equipment, providing it to people like ourselves, would dry up because of the sole sourcing that the Bell Operating Co., in fact would do within their own components structure.

So as a—

Senator EXON. You are against the Bells getting into the business.

Mr. ROBERTS. That is correct.

Senator EXON. I am surprised because I would think the more people in the business, the better it would be for you. But you must have your reasons.

Mr. Snedaker, do you agree with him?

Mr. SNEDAKER. No, I think we look at it a little bit differently. One, if you get into manufacturing large switches, the requirements for developing the software are so great that we do not see the Bell Co. getting into that business. For example, IT&T had their System 12 and they invested over a billion dollars. That caused part of their problems.

So to the extent that the Bell Co., would get into manufacturing, be it offshore, onshore, and certainly onshore would help the balance of payments, I would think, situation, and to the extent that it was fair competition, and that there was not directing or giving favorable treatment to some companies in contrast to others, we would not have any trouble with that.

Senator EXON. Thank you very much.

Senator INOUE. Senator Adams.

Senator ADAMS. Gentlemen, I am sorry for the substitution, but the vote is on, and we do know that all of you wish to be heard, and so that you will rest at some ease, I spent ten years in telecommunications in the House of Representatives and eight in private practice, and I am back as a Senator. So I am not completely unfamiliar with your problems.

I have known Judge Greene for many years and have great respect for him. So I also am familiar with the Modified Final Judgment.

Are there any further comments that you would like to make for the record at this time? As I say, I apologize for our coming in and going out, and Senator Inouye and Senator Exon will be back as soon as the vote is finished. But I would be most happy to receive any further comments, and I am going to ask staff if they have any further questions that Senator Inouye may not have been able to ask.

Any further comments, gentlemen?

Mr. SNEDAKER. Senator, I would like to make just one, just to maybe repeat for emphasis that in the present situation that we have in competition in long distance, that interexchange carriers, excluding AT&T, but including MCI, US Sprint and others, have a disadvantage in competing within LATA's, within basically metropolitan calling areas in that that traffic, for example, in the State of Connecticut, all the long distance traffic within the state there is handled by the telephone company, southern New England, and none in effect by MCI or US Sprint, so that in looking at that situation which is under the jurisdiction of the state commissions, we understand that, but we have open competition interstate, but when we get into certain States—and this changes gradually, but in effect we do not have competition to the extent we should on an intraLATA basis within the states.

I just mention that so that—

Senator ADAMS. Well, you are representing US Sprint, Mr. Snedaker. You would wish to have the ability to apply for and compete on the intraLATA as opposed to interLATA basis, is that correct? Is that what you are stating to me?

Mr. SNEDAKER. I am saying we should compete in a similar matter intraLATA as compared to interLATA.

Senator ADAMS. Would you allow that for all of the competitors or just the non-AT&T competitors?

Mr. SNEDAKER. Well, AT&T is prohibited by the MFJ—

Senator ADAMS. I know they are, but you are talking about a statutory change, and what I wanted to know was whether or not you wanted to have them brought in as well?

Mr. SNEDAKER. If we are in favor of competition, I would have to say yes. And we are in favor of competition.

Senator ADAMS. Well, I did not ask you that.

Mr. SNEDAKER. The answer is yes.

Senator ADAMS. All right.

Now, would you let the BOCs out into interLATA competition?

Mr. SNEDAKER. No.

Senator ADAMS. Any other comments?

That concludes the first panel.

If you have additional comments, you may submit them for the record, and the staff and other Senators may have questions they wish to submit. If so, I would appreciate it, gentlemen, if you would be willing to respond to those.

The next panel is a panel on manufacturing. Mr. Bruce DeMaeyer, president of Ameritech Services, Inc.; Mr. Curt Sampson, president, Communications Systems, Inc.; Mr. Herbert E. Marks, counsel to Independent Data Communications Manufacturers Association.

Is there a particular spokesman to this panel, or do you wish the Chair to simply call on you in any order?

All right, we will start with Mr. Marks since you are on my immediate left and the panel's right.

Mr. Marks, it is a pleasure to welcome you to the committee this afternoon, and we are pleased to receive your testimony, and if you wish, your full testimony will appear in the record, and you can summarize or you can read it. If you will please indicate to the Chair, why, I will rule on that.

STATEMENT OF HERBERT E. MARKS, COUNSEL, INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION

Mr. MARKS. Thank you, sir.

We would like to summarize our comments and submit the full statement for the record.

Senator ADAMS. Without objection, your full statement will appear in the record at this point, and the Chair is prepared to receive your testimony.

Mr. MARKS. The comments here today are of the Independent Data Communications Manufacturers Association which consists of high-tech data (meaning computer) communications equipment manufacturers. The IDCMA was formed in 1971 and since that date has participated in a large number of proceedings before the Congress, before the FCC, and before the courts, with the goal of assuring competition in telecommunications and in dependent and related markets.

Briefly, I would like to make a series of points addressing the issues before the subcommittee: the Modification of Final Judgment, its effects on competition and related issues.

First, the court reached the right decision on September 10, 1987, when it refused to modify the decree provision barring regional holding companies from manufacturing telecommunications equipment and customer premises equipment. The court also reached the right decision on December 3 when it clarified and defined the term "manufacturing" as it was defined in the original decree, that is, to include design and development.

Further, on the record presented to the court, the court could have reached no other decision within the constraints of the consent decree and the antitrust law which generated it. The regional companies retain a monopoly in local exchange and exchange access telecommunications services, and the Justice Department so conceded.

Further, the court properly determined that the FCC's rules and policies did not provide adequate safeguards to prevent the regional companies from engaging in anticompetitive conduct.

Given that the FCC has recently relaxed regulation by eliminating structural separation and that the alternative regulatory structure is incomplete in some respects and patently inadequate in others, the court's ruling should come as no surprise.

Now, we believe that it is clear that there is a local access bottleneck, and acting upon that bottleneck, the regional companies can foreclose competition by, one, refusing to purchase equipment for their own use except from their affiliates, two, by cross-subsidizing equipment that they market; and, three, by discriminating against competitors' equipment attached to their essential facilities. I will address each of those potential problems.

Cross-subsidy is feasible for several reasons. The regional companies can charge consumers monopoly rates. The consumer will pay the rates that they have to to get local phone service and for access to their interexchange carriers.

The commingling of regulated and unregulated activities permits and facilitates the transfer of funds and other assets and compounds the difficulties of oversight.

The FCC lacks the resources to regulate effectively and has failed to put in place a strong regulatory safeguard that would give at least an argument that predation could be prevented.

Market foreclosure and discrimination are feasible because the equipment is either included in the regional telephone companies' networks, or because the equipment is wholly dependent upon their networks as it must interconnect and technically interoperate with network facilities.

Accordingly, independent manufacturers are vulnerable to the regional companies' refusal to procure equipment from unaffiliated entities and refusals to provide, or to provide in a timely and non-discriminatory manner, such things as technical information, installation and maintenance or service of a specified quality for their basic services.

This vulnerability is particularly high for computer communications equipment.

The Modification of Final Judgment was carefully crafted as a result of a settlement reached by the U.S. Government and the Bell System. The settlement ended the Government's 1974 antitrust case and revised the 1956 consent decree which ended the

Government's 1949 case. It was intended to provide an enduring solution to decades of problems.

The MFJ itself provides for the relaxation of restrictions, and I quote, "upon a showing by the petitioning BOC [Bell Operating Co.] that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter." Thus, the decree itself has a sunset provision.

But under present circumstances, the regional companies have not met this standard.

In conclusion, the manufacturing markets sought to be entered are competitive, the regional companies are healthy, the process is working, and there is no need for legislation on this subject.

Thank you.

[The statement follows:]

STATEMENT OF HERBERT E. MARKS, COUNSEL, INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION [IDCMA]

Mr. Chairman and Members of the Subcommittee:

My name is Herbert E. Marks of the law firm of Squire, Sanders and Dempsey. I appear today as counsel for the Independent Data Communications Manufacturers Association (IDCMA). Since its inception in 1971, IDCMA has been an active participant in Congressional, administrative and judicial proceedings including the ongoing antitrust proceedings before Judge Harold H. Greene, where it has endeavored to secure competition in telecommunications and in related or dependent markets. The IDCMA companies manufacture high quality data (computer) communications equipment in the United States. The United States is a net exporter of data communications equipment and its manufacture is a vital and growing part of the "high-tech" sector of our Nation's economy.

I shall present my brief statement and look forward to your questions.

We shall submit for the record a number of documents that analyze the history of the antitrust case that generated the Modification of Final Judgment, the post-divestiture environment, the issues which effective implementation of the consent decree presented to the District Court, the Court's September 10, 1987 decision in response to the motions of the Department of Justice and the Bell Regional Companies by which they sought to modify the MFJ, and the Court's December 3, 1987 decision on the definition of "manufacturing."

As manufacturers and suppliers of sophisticated communications equipment, IDCMA's member companies operate in a technology-intensive, highly competitive, unregulated environment which would be severely distorted by the entry of the Regional Companies—entities which possess monopoly control over the local exchange network and the ability to leverage that control over adjacent or dependent markets. Our focus is on the issues posed by the manufacturing provisions of the MFJ, but much of our analysis has broader application.

The IDCMA position may be summarized as follows:

1. The Court reached the right decision on September 10, 1987, when it refused to modify the decree provision which bars the Regional Companies from manufacturing telecommunications equipment and customer premises equipment ("CPE"), and on December 3, 1987 when it clarified that the term "manufacturing" includes the design and development of equipment.
2. On the record presented, the Court could have reached no other decision within the constraints of the consent decree and the antitrust law which generated it.
3. The Regional Companies retain a monopoly in local exchange and interexchange access telecommunications and the Justice Department so conceded.
4. The Court properly determined that the FCC's rules and policies do not provide safeguards to prevent the Regional Companies from engaging in anticompetitive conduct. Given that the FCC has recently relaxed regulation by eliminating structural separation and that the alternative regulate in others, the Court's ruling should come as no surprise.
5. The Regional Companies can foreclose competition by:
 - refusing to purchase equipment for their own use except from affiliates;
 - cross-subsidizing equipment that they market; and
 - discriminating against competitor's equipment attached to their essential facilities.

6. Cross-subsidy is feasible because:

the Regional Companies can charge consumers monopoly rates; the commingling of regulated and unregulated activities permits transfers of funds and other assets and compounds difficulties of oversight; and the FCC lacks the resources to regulate effectively.

7. Market foreclosure and discrimination are feasible because the equipment is either included in the Regional Companies' telephone networks or the equipment is wholly dependent on their networks because it must interconnect and technically interoperate with network facilities. Accordingly, independent equipment manufacturers are vulnerable to the Regional Companies' refusals to procure equipment from unaffiliated manufacturers and refusals to provide, or to provide in a timely and nondiscriminatory manner, technical information, installation, maintenance, or service of a specified quality for their transmission services. This vulnerability is particularly high for data (computer) communications equipment.

8. The MFJ was carefully crafted as a result of a settlement reached by the United States Government and the Bell System. This settlement ended the Government's 1974 antitrust case and revised the 1956 consent decree which ended the Government's 1949 case. It was intended to provide an enduring solution to decades of problems.

9. The MFJ itself provides for the relaxation of restrictions:

"upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter."

Thus it has its own sunset provision. But, under present circumstances, the Regional Companies have not met this standard.

10. The manufacturing markets are competitive and the Regional Companies are healthy, the process is working, and there is no need for legislation.

The following presentation is divided into two parts. The first describes the status of court proceedings. The second describes the issues peculiar to the MFJ's restriction on manufacturing and especially the implications for data communications equipment, the products produced by IDCMA companies.

THE CASE

The Modification of Final Judgment ("MFJ") ended the Government's 1974 antitrust case against American Telephone and Telegraph Company ("AT&T") and superseded the 1956 antitrust consent decree which had settled the Government's 1949 antitrust case against AT&T. After hearing from hundreds of interested parties, Judge Greene conditioned his approval of the original settlement upon the insertion of a number of changes, changes that were favorable to the Bell Operating Companies ("BOCs"). The original settlement, as submitted to the Court would have barred the BOCs from all activities except local exchange telephone service and local interexchange access services. It is important to remember that the *Court*, using its authority under the Tunney Act before it would approve the settlement, required provisions that permitted the Bell Companies to engage in more activities, and that permitted removal of the line-of-business restrictions upon a showing that the Regional Companies could not impede competition in the markets they wished to enter.

One concern of the *Court* at the time of divestiture was that the BOCs, then undergoing reorganization as parts of the seven new Regional Companies, might in the future no longer have the resources to ensure high quality local telephone service. Another concern was that the BOCs should not be forever enjoined by the consent decree from engaging in activities other than conventional telephone service, if it could be shown that the BOCs had lost the ability to leverage their monopoly power over local exchange service into the competitive markets from which they were barred.

At the present time the Regional Companies are among the most successful and prosperous corporations in the nation, American telephone service remains among the best in the world, and the Regional Companies, because of deregulation, have more ability than ever before to use their monopoly power to damage competition in the markets adjacent to, and dependent upon, telecommunications.

It should also be remembered that the communications equipment markets figured heavily in the Government's original case against the Bell system. One historical vestige of that case is the fact that these proceedings are still officially entitled *United States v. Western Electric Company, et al.* Western Electric, as we all remember, is the old name for AT&T's manufacturing unit. One of the theories advanced by the Justice Department, and accepted by the Court in its 1981 decision to deny AT&T's motion to dismiss on the evidence presented, was that the Bell System com-

panies "used their local exchange monopolies to foreclose competition in the terminal equipment market by refusing unreasonably to interconnect equipment not provided by the Bell System, or by unreasonably impeding such interconnection. . . ." 524 F. Supp. 1336, 1352 (D.D.C. 1981). More recently the Court has noted that:

[t]he Regional Companies are not permitted to manufacture telecommunications equipment because the danger of discriminatory design is so substantial, and because neither the Court nor regulatory authorities have any practical ability to recognize and police discrimination in technological design until it is too late. The alliance of exchange service and manufacturing was an overwhelming concern of the decree.

1986-1 Trade Cases (CCH) 62,055, 62,062 (D.D.C. 1986). Manufacturers of terminal equipment and CPE, such as the IDCMA companies, are understandably unwilling to see a return to such circumstances.

In order to assure that the MFJ could adapt to a changing technological and business environment in a procompetitive manner, the Court called for a report every three years on the state of competition and the continuing need for the restrictions. In February of this year, the Department of Justice filed its first Triennial Report. Later, motions were filed by the Department and the Regional Companies. These motions asked the Commission to relax the line-of-business restrictions. Once again, the Court had the benefit of comments from a large number of parties.

In its September 10 decision, the Court denied the motions of the Justice Department and the Regional Companies and retained the prohibitions barring the Regional Companies from offering interexchange services or engaging in the manufacturing of telecommunications equipment and CPE. It also refused to allow the provision of most information services. The Court did grant the motions to the extent of permitting the Regional Companies to offer information gateway services for videotex and to engage in other non-telecommunications activities.

In its December 3 decision, the Court ruled that "manufacturing" includes product design, development and fabrication. The Regional Companies had urged that the definition, and therefore the prohibition, be limited to the fabrication of telecommunications equipment. The Department of Justice had conceded that such a redefinition would exclude activities which engender the greatest danger of anticompetitive conduct, but disclaimed an understanding of what was intended by the decree. IDCMA and others argued that the term includes telecommunications product design and development. It is in design and development that any particular telecommunications product is engineered for the vast majority of its unique and valuable qualities.

Since its entry, the Court has granted numerous waivers of the MFJ and denied only a few. The process generally worked, from IDCMA's standpoint. This does not mean that IDCMA was satisfied with every ruling.¹

The Court has also been confronted with claims that the Department of Justice has not properly enforced the Decree. In its December 3 opinion the Court has found merit in certain of these claims. There have been claims of Regional Company evasion of the MFJ restrictions, without DOJ acquiescence. A number of these matters are reported to be under investigation. Recently the Department and a Regional Company (US West) have agreed to a consent order providing the terms for future compliance and civil penalties for any future violations. The Subcommittee should be aware of this background and may want to explore it with the Department. The Senate Judiciary Committee has also been concerned with this matter.

Having discussed the procedural status of the case, we now shall comment on the merits. The Government did not contend that the Regional Companies were not dominant in their market—local exchange service and interexchange access. Neither the Justice Department nor the FCC maintain that the Regional Companies are not dominant in this market. Indeed, the Department of Justice's own consultant, Dr. Peter Huber, found that virtually all of the crucial local exchange and interexchange access services and facilities are provided by local exchange companies.² The rhetoric about competition in local exchange markets *may* (or may not) describe conditions that will exist in the future; it does not describe conditions as they exist today.

¹ For example, the Court has granted waivers which permit the Regional Companies to acquire "conditional interests" in companies that are engaged in prohibited activities.

² See Huber, P., *The Geodesic Network* (1987) at 1.8 (general), 2.13 (short haul transmission), 3.7 (interexchange access generally), 3.10 (switched access), 3.35 (private line), 5.13 (data transmission).

The record before the Court also reflects that the Regional Companies, from their dominant position in local exchange service, still maintain their ability to leverage and to control adjacent or dependent markets. This is especially true for data communications, equipment, which is on the customer's premises and owned by the customer. This equipment connects with and is designed to interoperate with the facilities of the Regional Companies. Thus, the Regional Companies could eliminate a competitor manufacturing or marketing data communications equipment by refusing interconnection, changing the technical parameters of their system, performing discriminatory maintenance or installation for users of this equipment, or by cross-subsidizing their own operations. These activities, discrimination against competitors and preferential treatment for the carriers' own equipment, could take the form of a variety of different actions. The Government conceded that the Regional Companies have the capability of attempting these activities.

Of course, where the equipment is owned by the telephone company ("telco equipment"), the Regional Company can totally foreclose competition by simply refusing to purchase equipment from anyone other than its affiliate. Indeed, the Department's Report and Motion were based on the assumption that the Regional Companies were likely to purchase "substantially all" of their equipment from their affiliates. The telephone company has every incentive to do so. And, because telco equipment is used to provide monopoly services or services which are not subject to effective competition, the telephone company can pay higher prices to its affiliate and the higher costs will be made up by increased rates for consumers.

Increasingly, CPE and telco equipment must be directly compatible. Indeed, equipment of the same type may be used as both CPE and telco equipment. These developments mean that the ability to control the purchase of telco equipment also confers control over the market for the same equipment when it is marketed as CPE.³

The thrust of the Government's case was that the Regional Companies would have difficulty discriminating because of the existence of marketplace restraints working in concert with competitive safeguards imposed by the FCC in its rules and decisions. Thus, the Government's case was highly dependent upon quality of the FCC's prescribed safeguards.

In addition, the government's motion was predicated upon the Justice Department's withdrawal from an enforcement role. The Justice Department's proposals were measured against a record that showed, at a minimum, a reluctance for enforcing the decree.

There are several significant problems with the Government's argument with respect to data communications, and, as we shall see, with respect to its case in general.

The Government's expert, Dr. Huber, in the report which was the basis for the Department of Justice's action, virtually ignored the \$2.5 billion-per-year data communications equipment market. The discussion of this market consisted of a single footnote! At a minimum, this suggested a lack of care in examining the markets affected and the issues presented.

Even though he neglected the market as a whole, the Government's expert did recognize that certain data communications equipment was particularly vulnerable to the anticompetitive conduct of the Regional companies.⁴ Aberrations in network quality can seriously impair the operations of data communications equipment. Further, much of the equipment is attached to private lines which are customized for each user to one degree or another. With these factual circumstances as a predicate, the Government's contentions that the Regional Companies could not abuse their control over local exchange service were seriously undermined at the outset.

Another thrust of the Government's case was that inside dealing on equipment procurement was not a matter for concern under the antitrust laws⁵ and that, in any case, such discriminatory activities would be highly visible and thus prevented by the competitive safeguards embodied in the FCC's rules. The Government also looked to state regulatory commissions for safeguards. The Court carefully considered whether FCC-prescribed competitive safeguards were an adequate substitute for consent decree restrictions imposed pursuant to the Sherman Act. The Court found the FCC's safeguards to be inadequate, with respect to all types of telecommunications equipment. The Court rejected the Government's antitrust theory

³ See Report and Recommendations of the United States Concerning the Line of Business Restrictions at 156 n.303 (Feb. 2, 1987).

⁴ Huber, *supra* at note 2, at 17.11.

⁵ DOJ Report, *supra* at note 3, at 169-70.

noting that a major focus of the case was the refusal to deal with unaffiliated manufacturers.⁶

The FCC recently abandoned its requirement requiring that regulated and unregulated activities be conducted through separate organizations with separate facilities and personnel. Thus, the activities may now be commingled making enforcement much more difficult.

The Justice Department, in its Triennial Report, submitted that the FCC could block cross-subsidies from a Regional Company's monopoly-regulated operations to its unregulated competitive operations by virtue of accounting and audit rules. Yet, when the Triennial Report was filed, the rules had not even been released by the FCC. As of today, they are not yet fully in effect. The Commission is still considering manuals implementing the rules. Further, the General Accounting Office has questioned the FCC's capability to enforce the rules effectively. One should note that the FCC has yet to prescribe formally⁷ that the cost accounting manuals must be in a standard form. Thus, the Regional Companies, by using atypical procedures, can eliminate, or at least seriously impair, the value of the manuals as a benchmark.

Even if a uniform set of cost allocation procedures for all seven Regional Companies were to emerge, the value of accounting separations is open to question. The FCC's attempt from 1965 to 1975 to use cost accounting procedures to determine the appropriate pricing of the Bell System's various interexchange services and whether they cross-subsidized its manufacturing activities became an interminable morass.⁸ Later, the FCC determined that accounting requirements and structural separation of regulated and nonregulated activities were *both* essential; each complemented the other.⁹ But now the Commission has jettisoned structural separation, placing much greater reliance on accounting strictures.

Another example is appropriate. In order to market a new data communications product, it is necessary to understand technical parameters of the Regional Companies' network. If there is going to be change in that network, it is necessary that all manufacturers know the nature of that change so that they can design new equipment or redesign old equipment. If a manufacturer affiliated with a Regional Company and a nonaffiliated manufacturer are to bring their equipment to market at the same time—or to have the opportunity to try to do so—they must have the information about the changes in the underlying network at the same time. This is one of those situations which sometimes is characterized as a "level playing field". Yet, the FCC's rules are skewed in favor of the Regional Company affiliate. A Regional Company is required to disclose information about changes in the network's operating parameters only when it makes a "make/buy" decision either with respect to equipment embedded in the network or to CPE which would rely on a change in the network. Unfortunately, the "make/buy" point comes rather late in the product cycle. The Regional Company could thus do all of the research, development and design before it has to make any disclosure. When it determines whether to internally fabricate or have the work externally done, only then does it have to release the requested technical information. In product terms, this can mean a 12-month, 18-month or even 24-month lead on the competition. The Commission has resisted, on numerous occasions, making the rule for all parties symmetrical. Similar disparities exist with respect to customer proprietary network information, which is also patently skewed in favor of the Regional Companies.

There are other examples which are listed in the IDCMA pleadings and include such sensitive competitive matters as the potential manipulation of cost-based pricing, the "unbundling" of Basic Service Elements ("BSEs") according to the FCC's new Open Network Architecture ("ONA") scheme, and the absence of equality in colocation in carriers' central offices of customer-owned equipment.

THE EQUIPMENT MARKET

Competition now exists in the data communications equipment market, in the CPE market generally, and in the telecommunications equipment market generally. Indeed the FCC has consistently cited the highly competitive CPE market as a hallmark for its success in deregulation. There is every indication that competition in these markets—whether selling equipment to the telephone companies or the old

⁶ *United States v. Western Electric Company, et al.*, No. 82-0192, slip op. at 82-84 & n.138 (Sept. 10, 1987).

⁷ See *Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities*, 2 FCC Rcd 1298, 1327-28 (1987).

⁸ See *Nader v. FCC*, 520 F.2d 182, 205-07 (D.C. Cir. 1975).

⁹ *BOC Structural Separation Order*, 95 FCC 2d 1117, 1125-26 (1983).

Bell System or selling CPE to users of network services—is vigorous and with a high level of innovation.

Future.—The original proposal brought to the Court by the United States and by the defendant called for absolutely barring the Regional Companies from all activities except for local exchange and interexchange access services. The Court rejected that approach and insisted that the Regional Companies have the opportunities to engage in other activities. It encouraged the parties to agree to permit yellow pages publishing and marketing of CPE. It provided provisions for waiver and indeed it provided for the ultimate elimination of all restrictions. The predicate for the relaxation of restrictions is built into the decree itself. The decree provides:

The restrictions imposed upon the separated BOCs by virtue of Section II(D) shall be removed upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter.

United States v. Western Electric Company, et al., 552 F. Supp. 131, 231 (D.D.C. 1982). Thus, this Decree has its own sunset provision.

In the view of IDCMA, the process is working. The Court entered the only order that was possible, given the record before it and the inadequacies of the alternative enforcement mechanisms. Further, the Decree itself provides for change when change is proper.

Consequently, while the Congress should keep itself informed of important developments affecting telecommunications, there is no need for Congressional action based on the activities of the consent decree Court.

Thank you for this opportunity to provide this statement. We will submit separately a variety of documents that further elaborate upon IDCMA's view of this matter, the record before the Court, and the Court's decision.

[The following information was subsequently received for the record:]

SQUIRE, SANDERS & DEMPSEY
Washington, DC, December 21, 1987.

Senator DANIEL K. INOUE;
Chairman, Subcommittee on Communications, Committee on Commerce, Science and Transportation, Washington, DC.

DEAR CHAIRMAN INOUE: As I indicated in my December 10, 1987 testimony before your subcommittee, I am herewith submitting for the record four documents relevant to the manufacturing restrictions of the AT&T consent decree. They are as follows:

1. An uncorrected transcript of the oral argument which I made before Judge Greene on June 30, 1987 on behalf of several trade associations representing the communications manufacturing industry;

2. IDCMA's submission to Dr. Peter Huber, the Justice Department's expert consultant for the triennial review, concerning the state of competition in the communications equipment market;

3. A discussion of international trade issues and the manufacturing restrictions, which was appended to IDCMA's March 13, 1987 comments on the Justice Department report; and

4. A chronological description of the manufacturing process which explains the distinction between "manufacturing" and "provision" of communications products.

I respectfully request that this letter and the attached documents be entered into the record of the subcommittee's hearings of December 10-11, 1987.

Sincerely yours,

HERBERT E. MARKS.

Enclosures ¹

Senator ADAMS. Thank you very much for your comments on that, Mr. Marks.

I just have one question and then I am going to go immediately to the other panels. I do not intend to question fully.

When you state that regional companies can charge consumers monopoly rates, are you referring to consumers of manufacturing items and so on? You weren't referring to phone rates, were you?

¹ The enclosures were not reproducible and are in the Committee files.

Mr. MARKS. Yes, sir. The phone company can pass on its costs to its customers, the users of phone service, and it can do that——

Senator ADAMS. Within the regulated system.

Mr. MARKS. Yes, and it can go to the regulatory commission and say it needs x number of dollars, and one of the costs of doing business is the purchase of equipment.

Senator ADAMS. I thought maybe you were referring in some way that I did not quite understand to changes in the regulatory system because you are now dealing with regional BOCs rather than what were essentially before companies that were regulated by state regulatory agencies.

Mr. MARKS. Well, the regulatory structure, as far as its institutional arrangement is concerned, is still the same. There are some proposals to vary the nature of the regulation imposed by the various institutions, either the federal——

Senator ADAMS. But you are referring in your remarks here to impacts that they can present to regulatory bodies.

Mr. MARKS. That is correct.

Senator ADAMS. I am just trying to separate between manufactured items and commentary on that, and regulation of rates to ultimate consumers who are, of course, the phone users.

Mr. MARKS. That is correct, and the reasons that we have a consent decree and the reason that we have a problem is that the manufacturing market is dependent upon and interrelated to the telephone business, and that the ability to control the equipment market is a function of monopoly position in the telephone business.

Senator ADAMS. All right.

Mr. Sampson.

STATEMENT OF CURT SAMPSON, PRESIDENT, COMMUNICATIONS SYSTEMS, INC., ON BEHALF OF U.S. TELECOMMUNICATIONS SUPPLIERS ASSOCIATION

Mr. SAMPSON. Mr. Chairman, I will submit a prepared statement. Mr. Chairman, my name is Curt Sampson. I am here today on behalf of the United States Telecommunications Suppliers Association, a national trade organization which represents approximately 600 manufacturers and suppliers of all types of telecommunications equipment. I am a former president of USTSA. For the past several years I have served on USTSA's public advisory affairs committee. I am also President of Communications Systems, Inc. of Hector, Minnesota. It is a publicly held corporation with annual sales of approximately \$36 million.

CSI is engaged in the manufacture and sale of telephone station apparatus or connectors and electronic test equipment used primarily by local telephone companies and other telecommunications carriers.

I would like to thank the subcommittee for the opportunity to present USTSA's views concerning the modification of final judgment and the District Court's recent decisions reaffirming the decree provisions which prevent the Bell Operating Co.'s from manufacturing telecommunications equipment and customer premises equipment, or CPE, as we call it.

The message which I have been asked to deliver today on behalf of USTSA's members is really quite simple. First, since it was approved and implemented less than four years ago, the MFJ has had a dramatic and an extremely positive effect on telecommunications equipment markets in the United States.

Second, as the district court recently concluded, following its exhaustive triennial review of the MFJ, the manufacturing prohibition and the related decree provisions remain essential to the continued development of a dynamic competitive U.S. telecommunications equipment industry.

Mr. Chairman, the impact of the MFJ on the telecommunications equipment industry in this country simply cannot be overstated. Since the decree was implemented in January 1984, the industry has undergone a truly remarkable transformation. The increased competition spawned by the MFJ has yielded a number of very tangible benefits, most notably, significant reduction in equipment prices.

As I have indicated in my prepared statement, since the decree was implemented, prices of equipment sold by USTSA's members have fallen by as much as 30 to 50 percent. Prices for products sold by my firm have generally been reduced 35 to 40 percent.

You may ask why would any sane businessman be happy to see the price of his product so sharply reduced. The answer is quite simple: the MFJ has provided us with a meaningful opportunity to compete for sales to the biggest customers in the business, the BOC's, an opportunity that was virtually nonexistent prior to divestiture.

This is not to say that penetrating the BOC market has been easy. Price and nonprice competition with respect to items such as warranty protection, delivery schedules and after-sales service has been very, very intense. To succeed in the highly competitive post-divestiture environment, manufacturers have had to become increasingly efficient, innovative, and cost effective.

It is clear that the MFJ has increased the technological and economic dynamism of the United States equipment industry. In the District Court's words, there has been a flowering of research, development, introduction of new products and quality assurance. New firms have entered the market. Prices of equipment have declined dramatically. And competition flourishes in a market that had seen very little of it before.

The figures cited in my testimony give you a good idea of the magnitude of the MFJ's impact on the growth of competition within the U.S. equipment industry. Since entry of the MFJ, the percentage of equipment purchased by the BOC's from Western Electric, now ATT Technologies, declined from 92 percent in 1982 to an estimated 57.6 percent in 1986. By contrast, my company's sales to the BOC's have increased from 1 to 2 percent of our revenue prior to divestiture, to approximately 45 percent today.

In almost all instances, our new BOC sales involve functionally equivalent products available from either CSI or Western, both before and after the divestiture.

These figures are all the more startling in light of the continuing difficulties faced by alternative suppliers seeking to displace incumbent AT&T products. Typically, new suppliers and their products

must undergo rigorous analysis by the BOC's and offer significant cost savings or other benefits to the operating company in order to successfully penetrate the BOC market. The tremendous shift in this BOC procurement pattern following entry of the MFJ, despite Western's well-entrenched position, confirms both the need for and the effectiveness of the MFJ restrictions.

I should note that during the District Court's triennial review proceeding, USTSA and other equipment industry associations were not alone in supporting retention of the manufacturing prohibition. Leading consumer advocates, state regulators and other industry participants, recognizing the benefit of increased competition in the equipment sector, also urged the court to maintain the current restrictions.

In assessing the validity of claims that the manufacturing prohibition is no longer needed, it is important to recall the history of the restriction. The government's 1974 antitrust suit and the MFJ ended more than 30 years of controversy focusing to a significant extent on the competitive problems associated with AT&T integration into adjacent, potentially competitive telecommunication equipment markets. In addition to the two major antitrust suits brought by the government and a number of private lawsuits, the FCC spent enormous resources over many years attempting unsuccessfully to ensure that BOC procurement decisions were based on cost and the quality of the product rather than the corporate affiliation of the equipment supplier.

In the 1974 litigation, the Justice Department presented persuasive evidence showing that the operating companies had engaged in several forms of anticompetitive conduct, including biased equipment purchasing practices, discriminatory equipment interconnection requirements, and preferential information disclosure practices, as well as the cross-subsidization of equipment prices from monopoly service revenues.

The MFJ was intended to put an end to these practices by severing the corporate tie between the BOCs and Western Electric and divestiture and prohibiting BOC integration to equipment manufacturing activities after divestiture.

Recently the District Court concluded, on the basis of an extensive record, that no changes had occurred since the MFJ was entered that would justify removal of the manufacturing restriction. The court found that the BOCs collectively control almost three-quarters of the telephone equipment purchases in the United States. The purchases of a single RBOC may constitute as much as 20 percent of domestic consumption of certain types of equipment. Because they are rate-based regulated monopoly providers of local telephone services, the BOCs lack the normal competitive constraints that prevent other firms from engaging in anticompetitive abuses of the sort which led to the entry of the MFJ.

Removal of the manufacturing restriction at this time would threaten a return to foreclosed equipment markets. The largest, most economically powerful group of equipment purchasers would become the competitors of their existing suppliers, with strong incentives to prefer their own products and cross-subsidize manufacturing operations through revenues received from local ratepayers.

Renewed foreclosure of domestic markets would not only reduce competition and innovation in the United States, it would also jeopardize the ability of efficient U.S. manufacturers to secure the domestic customer base necessary to compete effectively abroad.

In short, premature removal of the MFJ manufacturing restriction would place at serious risk the progress achieved since divestiture toward the development of a more competitive telephone equipment market and industry.

USTSA urges you, Mr. Chairman, and members of the subcommittee, to support the District Court's decision to maintain the current restriction which is firmly grounded in logic and history as well as pre- and post-divestiture industry experience.

Thank you.

Senator INOUE. Thank you very much, Mr. Sampson.

Our final witness is the President of Ameritech Services, Mr. Bruce DeMaeyer.

STATEMENT OF BRUCE DeMAEYER, PRESIDENT, AMERITECH SERVICES

Mr. DeMAEYER. Mr. Chairman, Senator, thank you for the opportunity today to testify before the Subcommittee on Communications. My name is Bruce DeMaeyer. I am president of Ameritech Services, the service subsidiary of the Ameritech operating companies.

I will address the manufacturing prohibition of the 1982 decree and two recent decisions regarding that prohibition. My written statement is being submitted for the record, and I will not try to repeat that here. Instead, I will limit my remarks to the effect of the court's decisions on innovation.

On September 10, 1987, the divestiture court denied motions by the Department of Justice and the regional companies to lift the manufacturing prohibition. Last week the court issued a second opinion that in our view greatly expands the manufacturing prohibition.

I need to be clear that Ameritech's interest is not to replicate the 200,000 or so products that the old Bell System used to manufacture through Western Electric. The vast majority of the product manufactured by Mr. Sampson and Mr. Marks' clients are good products, and there would be little or no reason for us to duplicate their manufacturing efforts. Ameritech's concern from a business standpoint is primarily in the development of new, leading edge technologies and products that would allow us to offer better services at lower price.

The court's decisions prevent us from developing these needed technologies and products. Without this ability, the regional companies will be unable to meet consumer needs for lower cost and improved telephone services. Ten years ago, the U.S. public switched telephone network was an engineering marvel of the world. Under these new decisions, America's competitive advantage as the world leader in telecommunications technology I believe to be in serious jeopardy.

In my written statement I cited two examples of new technologies that are critical for improving telephone services. These tech-

nologies are being developed by Bell Communications Research, a telecommunications research firm owned jointly by the regional companies. The first development is a new technique for speeding the transmission of information through fiber optic cables used in the regional companies' networks. Business and Government users need this faster information transmission to improve the efficiencies of their operation and to stay competitive with foreign businesses and Governments.

The second development is a prototype of a system that would allow hearing impaired people to converse with hearing people through the telephone network by converting speech into text and vice versa. If this latter technology is perfected and allowed to be deployed, hearing impaired people will be able to use teletypewriters to communicate with anyone who has a simple Touchtone telephone. Under the court's expansion of the manufacturing prohibition, it is now very unclear how these new, important technologies will, if ever, be brought to market.

The regional companies have \$150 billion invested in their local networks and are continuing to invest in their networks at the rate of some \$15 billion a year. This enormous investment gives the regional companies a focus on improving and enhancing local telephone service. However, since we are barred from manufacturing, we must rely on independent manufacturers to provide new products for improving service. Independent manufacturers, from the very largest especially on down, have incentives to support their own existing product lines, their own schedules, and their own inventories rather than develop new products or designs required by us as regional companies. They are often reluctant to assume the financial risks that are often associated with developing new, leading edge technologies and products.

Moreover, the unaffiliated manufacturers often have their own business plans that conflict often with the need to develop new technologies for improving telephone service and decreasing its cost.

We believe that Congress's policies are clear. The antitrust laws benefit consumers by opening up commerce to the maximum number of firms in order to decrease price and increase innovation. Where innovation and trade issues are presented, the antitrust laws should not be interpreted as a roadblock. The court's rulings contradict this policy by artificially preventing seven of the most capable firms from providing needed competition.

The statutory telecommunications policymakers, the FCC, which administers the act of 1934, and many of the state regulatory commissions which regulate under state statutes, have spoken. They say that the manufacturing prohibition should be lifted. The Department of Justice, which enforces the antitrust laws, concurs.

But the divestiture court has spoken also. Instead of removing the manufacturing prohibition, it has in fact now expanded it.

As a result, consumers are being denied the best possible telephone service. American jobs are being exported overseas. The U.S. trade balance is worsening. And America is losing its technological advantage. The 1982 decree, as administered by the court, we believe is frustrating Congress's clear policies.

Thank you, Mr. Chairman, for giving me the opportunity to appear before the subcommittee.

[The statement follows:]

STATEMENT OF BRUCE R. DEMAEYER ON BEHALF OF AMERITECH

Thank you for the opportunity today to testify before the Subcommittee on Communications. My name is Bruce Demaeyer. I am President of Ameritech Services, Inc., the core service subsidiary of Ameritech. As one of the regional companies still subject to the 1982 divestiture consent decree, Ameritech is critically concerned with the subject of these hearings.

I will address the manufacturing prohibition of the 1982 decree and two recent decisions regarding that prohibition. Those decisions are denying consumers the benefits of Congress's policies respecting innovation, trade, and competition. As a result, new technologies, such as a technology for allowing the deaf to communicate with hearing persons over the telephone, are not going to be available at reasonable prices or in the timeframes needed.

I. THE COURT'S MANUFACTURING RULINGS

In 1974, the Department of Justice brought an antitrust case against AT&T alleging two types of misconduct respecting the telecommunications equipment markets. The Department claimed that the Bell System made it difficult for independent manufacturers to connect their equipment to the network, and that the Bell System bought mostly equipment manufactured by its Western Electric affiliate even though lower cost or better performing equipment was available from independent manufacturers. As a corollary to the second claim, Western Electric did not sell equipment to the external markets, which would have provided a competitive test of the price and performance of its equipment.

The Department's claims were never decided. Instead, the Department and the Bell System settled the lawsuit by a consent decree that among other things divested the regional companies from AT&T and prohibited the regional companies from manufacturing telecommunications products.

At the same time that the Department was litigating its 1974 lawsuit, the FCC had begun independently to address the same issues. Even before the 1982 decree, the FCC had successfully addressed the issue regarding interconnection to the networks of independently-manufactured equipment. Competition for equipment requiring interconnection opened up and flourished under the FCC's rules prior to the divestiture. The FCC also had begun to address the procurement issue raised by the Department's lawsuit, but the divestiture preempted the FCC's proceedings and they were discontinued.

During 1986 and early 1987, the Department of Justice conducted a detailed factual study of the equipment markets, and based on that study found that the manufacturing prohibition of the decree was no longer needed. The FCC and most state regulatory commissions who commented concurred in the Department's findings. Accordingly, the Department and the regional companies requested the divestiture court to remove the manufacturing prohibition.

On September 10, 1987, the court issued its ruling regarding whether to lift the manufacturing prohibition. The facts presented and the court's treatment of them are summarized in the table below:

<i>Facts</i>	<i>The court's findings</i>
1. Divestiture fragmented the market power of the former Bell System and eliminated any realistic danger of competition.	Divestiture was not a "changed circumstance."
2. The regional companies, unlike the former Bell System, would sell to external markets—creating a litmus test for the quality and price of their products.	Not addressed.
3. Regional company manufacturing would improve the balance of trade and create jobs.	Regional company manufacturing could injure trade.
4. Network equipment markets are dominated by a few powerful firms (e.g., AT&T, GTE, Northern Telecom, NEC, Siemens, and Alcatel); additional competition would be beneficial.	The regional companies might drive existing manufacturers out of business.

*Facts**The court's findings*

5. Regulation has been proven effective..... Regulators have insufficient resources and willingness to safeguard competition.

Based on these findings, the Court denied the motions to remove the manufacturing prohibition. The Department and the regional companies have appealed that decision.

Last week the court issued a second ruling defining and expanding the scope of the manufacturing prohibition. In that ruling, the court held that the manufacturing prohibition includes all "design and development" of products for making available new technologies, as well as software development that is "integral" to making the hardware "work." The court stated that the regional companies are permitted only to issue "functional specifications" for equipment they use in their networks or resell to customers. The regional companies are prohibited under the ruling from performing "engineering design, product development, fabrication engineering, and actual production."

The court rejected arguments that design and development work is essential to meeting consumer needs for improved services. Finding that "automobile dealers throughout the United States manage quite well to sell cars without also designing them," the court reasoned that the regional companies could do the same. The court also rejected arguments that an expanded manufacturing prohibition would adversely affect competition and consumer welfare, stating that those arguments have "no relationship to the subject matter at issue."

II. THE COURT'S MANUFACTURING RULINGS ARE CONTRARY TO THE PUBLIC INTEREST

The manufacturing prohibition as interpreted by the court is hurting consumers and the American economy in three ways—by inhibiting the development of needed technologies, by adversely impacting the balance of trade, and by eliminating significant competition in the equipment markets that would reduce the cost of providing telephone service.

Technology denied.—Last week's ruling that the regional companies cannot effectively participate in the design or development of new technologies will have a greater effect on consumers and the national welfare than the divestiture itself. Without the ability to design or develop new products, the regional companies will be unable to meet consumer needs for lower-cost and improved telephone services. America's competitive advantage as the world leader in telecommunications technology will be lost.

The regional companies have some \$150 billion invested in their local networks, and are continuing to invest in their networks at the rate of \$15 billion annually. This enormous investment gives the regional companies a focus on improving and enhancing local telephone service that is not shared by unaffiliated manufacturers. Unaffiliated manufacturers have incentives to support existing product lines, schedules, and inventories rather than to develop new products or designs required by the regional companies. They are reluctant to assume the financial risks associated with developing leading edge technologies and products. Moreover, the unaffiliated manufacturers often have their own communications companies that compete with regional company services and whose needs for new technology development receive first priority.

Developing new telecommunications technologies is not like ordering a new car. An automobile dealership can simply select options from a manufacturer's catalog. But for a regional company seeking a new telecommunications technology, there is no catalog to order from. By prohibiting the regional companies from directly or indirectly participating in design and development activities, the court has denied to the nation the contribution that the regional companies can make in developing new technologies needed for providing new and better services.

It is important to understand the crippling effects of the court's rulings in concrete terms. Let me take two examples of new technologies that were announced just this past month. Both technologies were developed by Bell Communications Research, a telecommunications research firm owned jointly by the regional companies. The first development is a new technique for speeding the transmission of information through fiber optic cables used in the regional companies' networks. Business and government users need this faster information transmission to improve the efficiency of their operations, and to stay competitive with foreign businesses and governments. The second development is a prototype of a system that would allow deaf persons to converse with hearing persons through the telephone network, by

converting speech into text and vice versa. If the latter technology is perfected and allowed to be deployed, deaf persons will be able to use teletypewriters to communicate with anyone who has a touchtone telephone. (See the article attached to this statement.) Both these new technologies show tremendous promise. Yet under the court's interpretation of the manufacturing prohibition the regional companies may not bring these technologies to market. Critical business applications and the deaf will have to wait.

Congress's policy respecting technology development is clear. The National Cooperative Research Act of 1984 embodies a policy that the antitrust laws should not prevent the development of new technologies needed for the competitiveness, security, and welfare of this country. Yet, the court held that this Act "sheds no particular light" on the 1982 decree, and has adopted an interpretation of the manufacturing prohibition that will inhibit rather than promote new technology development.

Trade.—The divestiture and the manufacturing prohibition have devastated the United States balance of trade. In 1982, the United States enjoyed a telecommunications equipment trade surplus of \$580 million. By 1986, that surplus had turned into a deficit of \$2.1 billion. For the first nine months of 1987, the deficit was already \$1.8 billion.

The vast bulk of this trade deficit is caused by sales of foreign-made equipment directly to customers that provides features the regional companies have been prohibited from developing for their networks. Under last week's expansion of the manufacturing prohibition, the trade losses may be expected accelerate.

The manufacturing prohibition has not protected American manufacturers or American jobs. To the contrary, half of all private business switches (PBXs) and virtually all telephones are now manufactured overseas. The largest domestic manufacturer, AT&T, has laid off thousands of U.S. manufacturing workers while moving its manufacturing operations offshore to Singapore and Korea.

Congress's policy respecting trade is clear. The Foreign Trade Antitrust Improvements Act of 1982 embodies a policy that the antitrust laws should not prevent domestic manufacturers from improving trade. Paradoxically, the court has permitted the regional companies to establish manufacturing jobs overseas to manufacture equipment for sale in foreign countries. But the regional companies are still prohibited from creating manufacturing jobs here in the United States, and from contributing to a positive balance of trade by selling American-made equipment.

Elimination of competition.—Contrary to the court's findings, the manufacturing prohibition is not needed to protect competition; it serves only to exclude seven capable firms from the marketplace. As a result, consumers are being denied the benefits of Congress's pro-competition policies.

The critical network equipment markets are dominated by a few, powerful manufacturers. Three firms manufacture over 90% of all central office switch equipment sold in the United States. Three firms manufacture 85 percent of all optical fiber. Three firms manufacture 75 percent of all microwave equipment.

Under the Court's ruling, the regional companies not only are prohibited from developing new equipment, but also from developing the technologies to modernize the equipment they already own. Thus, a concentrated group of manufacturers has a court-sanctioned monopoly to control the capabilities of the national telecommunications network, the pace at which new services are introduced, and the price of service to consumers.

Again, Congress's policy is clear. The antitrust laws benefit consumers by opening up commerce to the maximum number of firms in order to decrease prices and increase innovation. The court's rulings contradict this policy by artificially preventing seven of the most capable firms from providing needed competition.

CONCLUSION

The statutory telecommunications policymakers—the FCC which administers the Communications Act of 1934 and many of the state regulatory commissions which regulate under state statutes—have spoken. They say that the manufacturing prohibition should be lifted. The Department of Justice which enforces the antitrust laws concurs.

the divestiture court has spoken also. Instead of removing the manufacturing prohibition, the court has expanded it.

As a result, consumers are denied the best possible telephone service, American jobs are exported overseas, the United States trade balance is worsened, and America is losing its technological advantage. The 1982 decree as administered by the court is frustrating Congress's clear policies.

Senator INOUE. Thank you very much, Mr. DeMaeyer.

On the last point that you brought up, Mr. DeMaeyer, that the restrictions on Bell Cos. have worsened our trade deficit, Mr. Sampson, Mr. Marks, do you concur with that?

Mr. SAMPSON. I would certainly not agree with it. Our own experience has been where we see the Bell System involved, or an RBOC involved someplace, currently in manufacturing or entering into some form of involvement, it either has involved products that are made overseas, or there is certainly the threat of it.

I think from the standpoint of them starting from ground zero in forming a manufacturing operation is pretty tough, I think competitively, I think the consensus of the USTSA is that it would worsen the situation rather than improve it.

Another aspect is that the local manufacturers, the stateside manufacturers, in being able to sell to the RBOCs, develop a certain amount of volume which enables them to go overseas and compete. A good example is recently I attended the TELECOM 87 in Geneva, and we happened to stumble into a situation where numerous European countries are thinking of coming to the U.S. standards or adopting U.S. interconnection standard, the plugs and jacks which everyone has become familiar with, and it has created an opportunity for the U.S. manufacturers because the foreign manufacturers are not involved.

Price competition that is going to be necessary to compete with Taiwan, Korea and other low labor countries, that situation will be helped greatly by having volume of business with the RBOCs.

Senator INOUE. Mr. Marks, would lifting the manufacturing restrictions improve or worsen the trade deficit picture?

Mr. MARKS. Sir, it would worsen the trade deficit for the several reasons. Before I discuss those reasons, let me first state that the argument on the trade issue has really done a disservice to the debate on U.S. international trade policy because it has shifted the focus from foreign trade barriers to this issue. Our root problem is that U.S. markets are open and foreign markets are often closed.

But proceeding further, as Mr. Sampson has said, there is a problem that if you allowed the Bell Operating Companies to enter into manufacturing, you in effect eliminate the U.S. market for independent manufacturers, which is a base for their world marketing efforts.

The history of telephone companies in manufacturing has been one of self-dealing. In the pre-divestiture period, AT&T tended not to export, being very comfortable with selling into its captive market. You sell into your captive market for a very good reason: you do not have any competition. So the affiliated manufacturer sells to the phone company, no competition, the phone company says they want to buy it, and then they pass along the cost to the end user, the telephone subscriber.

The Government, in its case before Judge Greene, conceded that it was likely—indeed, they expected—that a Bell Operating Company that is allowed to be a manufacturer would buy from its affiliate. And then the Antitrust Division said, that is not an antitrust problem, it is not a problem under the decree. The judge, of course, rejected that legal analysis.

Senator INOUE. Mr. DeMaeyer, would you like to contribute to this dialogue?

Mr. DEMAEYER. There are two areas where I have some difficulties with my two peers' answers. One of them seems to be an automatic assumption that all of the manufacturing that we would enter into would indeed be done with foreign entrants. There is almost no motivation for us to want to do that. We are all locally regulated companies. Our interest in creating local jobs and the positive effect that that has on the economy of our regions means that manufacturing domestically would be clearly in our best interest.

Ameritech, as you know if you are familiar with the decree, is already by waiver allowed to manufacture abroad, if it sells its products abroad. That kind of shows how stupid the issue really is in the sense that we are allowed to create foreign jobs but not allowed to create American jobs.

Given what has happened recently in the area of currency valuations, allowing us to manufacture here would help, we think, offset some of that trade balance for the same reason that is stated here: our products have a market overseas, and we would equally compete with my friends here in selling to the foreign marketplace.

So I do really believe that the issue does have a significant potential for improving the U.S. balance of trade and clearly has potential for creating new American job opportunities.

Senator INOUE. It has been argued that this restriction is necessary to permit the local manufacturer time to build a base, a strong base of operations.

How long will it take to develop the strong base of operations? Put another way, when will the market be competitive enough to accommodate the BOC's?

Mr. SAMPSON. In our particular case, we have been able to reduce our break-even costs substantially. If you will recall, I mentioned we went from selling only 1 to 2 percent of our total sales to the RBOC's up to 45 percent. In doing that, we have reduced our costs substantially. We are now very close to achieving parity with the, particularly Taiwan and Korea. We are noticing some of our customers that had defected on part of our product line coming back to us now because of the currency matter and because of our cost situation.

So I would say as of this point we have already achieved the status of probably the industry's low cost producer domestically, and very close to overseas, and I believe that other companies are enjoying some of the same benefits, and would not like to see it reversed.

I cannot agree more with my colleague from Ameritech, who incidentally, their firm was one of the few companies that did give us some business before divestiture, for which I am eternally grateful, and they are presently one of our good customers.

But I feel very strongly about the foreign trade issue, and I just wish that there was some way that we could see that their position is sustainable enough so that it would justify letting them come into the manufacturing arena, but I find it just very difficult to fathom.

Senator INOUE. But you do not believe that it is time to allow them into the manufacturing business.

Mr. SAMPSON. The problem could best be described this way. I think if they were manufacturing a product that we or someone else made that was a functional equivalent, the chance that they or their buyers could be truly objective, that they could be unbiased, that they could be uncontroversial in their selection is perhaps as likely as two proud fathers agreeing on whose baby is the cutest or smartest. It is very subjective. It would be very difficult. If they select their own, they are obviously suspect. If they would happen to choose our product over theirs, who in the world would they ever sell theirs to?

So I just think it is an inherent problem.

Senator INOUE. Even if your product is cheaper than theirs? Even if the price is better than theirs?

Mr. SAMPSON. Our products are very similar. We never say that ours are better than AT&T's. I believe if the Bell Operating Companies were to get into the manufacturing, they would produce a product as good as ours and as good as AT&T's. Their pricing would probably be competitive. They would probably have the benefit of a lot of their engineers who are engaged in various other engineering activities and on the payroll of their regulated companies who would certainly contribute to the designs and the research and so forth. Their pricing might be competitive, but a lot of the costs that we normally bear in developing a product, they would have the benefit of allocating those, or they would wind up in the rate-making process.

Mr. MARKS. Mr. Chairman, may I contribute a bit to this discussion here?

I would like to refer to Mr. DeMaeyer's criticism of independent manufacturers as his source by saying that they may have incentives to support their own product lines, and they are worried about taking risks. Our answer to the question is, but what would a regional holding company do? It would support its own product line and not want to take risks, and buy from itself. And that is exactly what the Justice Department said would be likely to happen.

So the result, with respect to one class of equipment under consideration, is a foreclosure of the U.S. market to independent manufacturers by virtue of the telephone companies buying from their affiliates. It is not unreasonable to expect a businessman to buy from his affiliate. The net result is you have eliminated the basis for equipment competition, the domestic market for those who sell to telephone companies.

There is a second class of market, the so-called CPE market where the equipment is not necessarily sold to the telephone company.

One of the problems we have today is you cannot neatly distinguish the two types of equipment because there are a lot of things that are CPE in one context that are sold to the telephone company in another context. There is equipment of this type that, when it is telephone company equipment, it really controls, in effect, the technical specifications of the CPE equipment. So the distinction is not total, but with respect to this type of telephone equipment, the problem is, of course, that the regional company again would have a preference for the equipment of its own that it manufactures and market. It has the ability to foreclose the market by discriminating

against its competitors' equipment because of the essential fact of life that there is a critical interdependence between the equipment that it connects to the network and the technical specifications of the network, information about it, the timely installation of lines, maintenance, et cetera. It has been that ability to control the adjacent market, the equipment market, that gives rise to the objection to the regional companies being manufacturers as well as their ability to hide costs or pass costs up to the telephone ratepayer.

If I might just presume, I think there are two points that ought not to go unanswered in the record as to what the court did or did not do.

It was stated that the court in the December 3 decision expanded the decree. The court did not expand the decree. The court interpreted the decree in the only way it could have, and that is that manufacturing is not simply the putting of little pieces in a box, but includes design and development. This ruling was based upon a number of many very good reasons. The best reason is a matter of law, that is what the record showed the parties meant when they drafted the decree, which is the legal test.

Quite aside from that, the Justice Department itself said that the ability to control the adjacent market, the critical problem in the product process was in design and development. That is where value added is, that is where software is developed, et cetera.

And the last item: it was said that there is something wrong with the process whereby the BOCs, regional companies can manufacture overseas but not in the United States, and the answer is some of us told the court that when it authorized overseas manufacturing, the BOCs were going to hit with us the question well, why do you not let us manufacture at home? And we said, "well, you know, it is the old slippery slope argument," and they said "no, because this is isolated from the domestic monopoly we are going to do it." And sure enough, here we are having the argument come back.

Senator INOUE. I would like to ask a question relating to the effectiveness of the FCC in preventing anticompetitive abuses.

The FCC has come up with cost allocation procedures and information disclosure rules. Do you think that these will help to guard against anticompetitive problems?

Mr. DEMAEYER. The FCC rules are right at the edge of being implemented now. Those procedures, the cost separation and allocation procedures, are now ready to be implemented at the first of the year. We have all submitted our procedures to the FCC for their review, and they are being passed upon. So now the test is ready to be applied to all of us to see whether or not it in fact does meet the test that the FCC has in fact asked of us.

In a more global sense, we believe that regulation is significantly more effective now than it was during the 1974 or before period. The problem cited during the trial of the 1974 antitrust case was that the Bell System itself was too big, much too big to be regulated effectively. Divestiture broke us up into eight manageable pieces. The existence of the seven companies having independent interests allows the FCC and other regulators to compare our conduct one against each other, so there are now better litmus tests, one against the other, that can be applied when determining

whether there are in fact cross-subsidies going on as are referred to as potential abuses.

The FCC has used these comparisons effectively in regulating our regional company interconnection practices and tariffs, for example, discussed by the preceding panel. That is a test that they frequently now apply, and I think and they think it works quite well.

Mr. SAMPSON. Mr. Chairman, on that issue of regulation preventing antitrust type activities or bias in purchasing, a couple comments.

No. 1, it has never been effective because it is very subjective frequently whether the product is indeed exactly the same, apples and oranges type situation and so forth.

There is another factor, and that is that any complaint or any issue that would arise and give rise to a complaint or a situation where maybe there is bias would undoubtedly take several years to come to the forefront and possibly get resolved, and it might put someone completely out of business, might do them irreparable harm, etc. In other words, there is such a regulatory lag, it does not matter if it is in rate cases or in matters such as that, there is always such a lag that regulation of this type of thing would not work because of the lag.

Now, in addition, as the gentleman from Ameritech has stated, at one time there were 200,000 products, and so you have maybe 200,000 opportunities for problems in seven RBOCs, and so the regulation of it, I think, is effectively completely out of the question. It is just too big an undertaking.

There is one issue I would like to address very briefly, and that is the way products normally are developed, not only in our industry but in many industries is the customer may have a suggestion. He may have a specification. And very often it does result in a product. In the pre-divestiture era, it was very common for a Bell Operating Co. to go to a manufacturer or to Western and have an idea and work with them to develop it, and this is a very healthy thing. After all, it is coming out of effectively the public sector in their particular case. It is coming from people who are paid by the public.

In today's environment, we find that the RBOC's tend to be very secretive, they tend to refer us to their patent license group, et cetera, you know, just indicating somewhat of a change here, and whether it is in this business or in some other business, it is very common for customers to come up with ideas, specifications, and I sincerely believe that USTSA's membership, which is over 600 and includes ITT, AT&T, et cetera, that if the Bell Operating Co. come up with a good idea or come up with parameters and they are willing to work with the manufacturers, there is plenty of technology, plenty of manufacturing capacity, plenty ability to produce whatever they want, and do it fast.

We have produced several products for Bell Operating Co. recently as quickly as 4 and 5 months. When a building is being built, for instance, we will go to work and have a product ready by the time it is ready. It is a common thing, and everybody stands ready to do it, and there are 600 strong in USTSA that would just love to help them.

Senator INOUE. Mr. Marks?

Mr. MARKS. Mr. Chairman, I will confine my response to your question which dealt with the cost allocation issue because there are really two kinds of or two classes of conduct that present a problem. One we will call cost, sometimes referred to as cross-subsidization, and then there is a whole other range of discrimination issues which, of course, the FCC in its joint cost proceeding did not even address. So I can respond to that later if you want to pursue that.

With respect to cost issues only, the answer would be multipart. It would be, first, the FCC has a long history of trying to get a good handle on costs, and the record is that they have not succeeded terribly well. It is a problem of very complicated accounting, big numbers, shortage of auditors, disagreements over accounting standards, disagreement over audit standards, et cetera. So the record ought not to make one terribly comfortable.

Secondly, this proceeding, narrowly viewed, deals with those costs of a regional company that are subject to Federal jurisdiction, and that is less than half. So you do not even have within this proceeding an attempt to isolate between regulated and unregulated all of the costs of the companies.

Next, this question of comparisons. Well, the Feds have one standard—which is not clear that it is even a standard for all of the companies subject to Federal jurisdiction. There can be some variabilities in the manuals. What will happen with these standards is not at all clear. But it is very clear that the Federal rules do not prescribe the accounting and audit standards for the states, so that you will have regional companies subject to some combination of Federal plus x number of state accounting and audit standards, and there is absolutely no requirement that those match.

Finally, in terms of warm feelings about the quality of FCC regulation on cost, quite aside from the historic problems with getting a good grip on costs, we have the fact that FCC regulation in the intermediate term has been decreasing, and in particular and in a very significant way, the FCC recently has abandoned structural separation in which it had originally said that the BOC's must conduct regulated activities through separate facilities and separate personnel that are different from those engaged in unregulated activities.

Now, they did not like that, and what they did was they put it all together where you have a commingling of regulated and unregulated. I do not think anyone can quarrel that as a matter of simple logic that that greatly compounds the problem.

So at a best, what we are looking at is a new, commingled system, a history of difficulty in regulation of accounting, and no experience with this brand new system. That is the best one can say.

Senator MCCAIN. OK. Mr. Sampson and Mr. DeMaeyer, do you both agree with Mr. Marks that the RBOC's should not be allowed to enter the design of products?

Mr. DEMAEYER. I certainly do not. I will elaborate on that. I think the issue of design from a definition of manufacturing is one that is not very definable by a clear bright line, when design stops

and when the next phase stops, in fact, even before that, when research ends and when design begins.

It seems to me that that effort continues on for a long time beyond the point when someone could clearly say it is done with design. That design needs to be checked later and so on.

The way it appears the most recent judge's definition of what is manufacturing, the way it appears to us now is that there is an appearance that he perceives us being able to simply order out of the catalogue, that there is going to be so much product out there that you just simply order one of those and order one of those; and that all we really need to do is describe in some specification way, in a very global way, we need something that does this and what are the products that are now available.

That just is not the reality of how it works in our industry.

Senator McCAIN. So inability for the RBOC's to design will harm their ability to service the customer?

Mr. DeMAEYER. I believe it will deeply harm it.

Senator McCAIN. Because they will not be able to supply the products that they believe are necessary to the customer?

Mr. DeMAEYER. It is because we will not be able to properly describe and define to the manufacturer, whether it be a manufacturer as represented by these two gentlemen or ourselves, to properly describe and define how the product should work.

You cannot simply argue that you must make the specification and that is the end of design. It goes far beyond that.

Senator McCAIN. Can I take the side of the manufacturers for a few moments. If I were a manufacturer, I would say, tell me what you want and I think I can build it for you. How do you respond to that?

Mr. DeMAEYER. My argument would be that I think you would get a better product if the customer had, working in conjunction with the manufacturer, a design team that was helping to more elaborately configure what that product really ought to be like.

I can give you a really good example of one that has taken place in my company very recently. It has to do with our relationship with the cable television industry. For many years, when cable television companies came in to install coaxial cables, the telephone companies needed to move their cables by approximately a foot or 18 inches to give clearance for cars driving underneath—very expensive to us and a portion of that cost was then billed to the cable television companies.

One of our bright engineers determined that moving all the cables was kind of silly, that what we really needed was a brand new bracket that could be installed right where our cable hole was in the pole, extending our cable and the cable television cables out horizontally.

Since we were not able to manufacture that product and probably would never go into that business even if we could, we took the idea to a steel fabricator and asked that steel fabricator to begin the development of that product for us using our design, and through an iterative process finally came up with a product that is now being installed all over the United States by that manufacturer's sales capability.

We think the design process helped that manufacturer in fact get into business and sustain a very productive business for him.

Senator McCAIN. Mr. Sampson.

Mr. SAMPSON. The input of someone as large as the RBOC's, needless to say, is extremely essential. After all, they are 70 or 80 percent of the access line market. We need that input and we would like to take products—I am sure Joslin or any other of a number of companies would have loved that product.

And I think the point is that the input probably comes from people who are engaged in local service activities and so forth that the public has probably paid for already. And getting them to make something is truly laudable.

The problem is that if they were to be permitted to actually manufacture, there would be no way that it could be done without probably hurting somebody else who would have been more than willing to do it in the first place. And there will always be the issue of impropriety and bias and so forth.

It just simply cannot exist.

Mr. DEMAEYER. Senator, if I could, that is exactly the point. There is an automatic assumption that we would have wanted to have built the whole thing, and I think that is a misconception of our desire to be a manufacturer. We would go through the normal ordinary make-buy decision on that, and it would be foolish for us to set up a steel fabrication line to manufacture it ourselves.

That is a normal way of doing business, to decide whether you will make or buy.

Mr. SAMPSON. One point that has not been made is, manufacturing in this definition did change as a result of the judge's ruling, because what happened in the last three years is that interpretations have come around that manufacturing really was fabrication or assembly only. And really, that is just one small part of manufacturing; it is the design and so forth, and that is the way the judge defined it.

But it had kind of wandered away that, hey, we can do everything except put it together. Now, we have a test equipment company that is a \$4 million subsidiary, that does not do any fabrication of its own products. It designs, develops, and does the final testing and so forth, but it does not even put it together. But it is very much of a manufacturing company.

So that definition I think the judge is pretty solid on.

Mr. MARKS. This is a point where one could trot out volumes of material. In the plan of reorganization, there was a division between systems engineering and the generation of generic requirements for network operations, and all of the research and development that went into that.

It says that, when it comes to the design of the specific equipment that meets that generic requirement, that is where you cross the line. And the benefit of that is, it allows the regional companies to take a look at generic technologies—is it better to go fiber, is it better to do it this way or that way—and then sets up in effect a competitive situation as to how you get to the best solution.

And that way you get the best of all possible worlds for the telephone user. He has an informed buyer, but does not share the risks of the buyer being locked into the nuts and bolts of its own specific

solution from its own manufacturer, its own source, and therefore locking in a given product line.

Senator MCCAIN. Thank you, Mr. Chairman.

Senator INOUE. Senator Pressler.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. Mr. Chairman, I will make just a brief statement.

I would like to begin by stressing how important this issue is to America's future. A coherent national telecommunications policy is essential if this Nation is to remain at the cutting edge of this technology. The telecommunications industry must know what that national policy is and the individual members of that industry must have confidence in their ability to expand and compete in this rapidly growing field without undue and burdensome regulation.

It is also important to America's future that we pursue the goal of a universal information service. Just as universal telephone service was a primary goal of the Communications Act of 1934, it is now our responsibility to ensure that information services are made available to all of our citizens. It is not yet clear that this can be accomplished without some oversight of the industry. This issue must be addressed and answered satisfactorily. In any rapidly developing technology, the large urban areas are normally the first to benefit from its implementation. We must not allow the small towns and rural areas of this country to fall by the wayside in this technological onrush. All of our citizens must have access to this technology, which will become more important in the future in both personal and business applications.

I am convinced that these two important goals—the encouragement of competition and provision of universal information services—need not be mutually exclusive. In most cases, competition is the best way to insure that the consumer gets the best product. But we must be sure that our actions foster true competition, rather than inhibit it. And most importantly, we must be sure that, in our attempts to foster competition, we do not sacrifice the pursuit of universal service at reasonable cost. The future competitiveness of large areas of our country depends upon this.

Mr. Chairman, I look forward to hearing all sides of this issue so that we can make well-informed decisions on this critical matter.

I have listened to Senator McCain's questions with a great deal of interest, especially his earlier ones about manufacturing. I recall during the hearings on this matter over the years, in which we did not really act but finally Judge Greene did, that we were always told that there would be very massive innovations and new equipment and new services and new research, and the technology and research would bloom forth.

In my judgment, this has not happened. He might disagree with that. I am throwing this out as a question. No. 1, do you think that has happened? And then No. 2, if you do not think it has happened, why not?

Mr. SAMPSON. As to products that I personally, our company uses, I see a lot of technology. I see FAX, which is a recent one,

coming along so fast that it is almost as common as an office copier nowadays. How you can operate without a FAX machine, I do not know.

As far as new equipment, in our own experience we are developing products at an extremely fast rate, particularly in the data product area, local area networks and so forth. And I see other people really doing the same. The USTSA members I think are turning out more products now than ever before.

I really think the progress has been extremely good, and the equipment that we are buying, whether it is a simple answering machine that is telling you the time the call came in and all kinds of other things and they can buy it for \$100, I think it is remarkable.

We used to sell answering machines that did a fraction of that 5 or 6 or 7 years ago and it sold for \$1,000, and now it is ten times the machine for \$100. I think it is truly remarkable.

In our own connector business, our product line is moving all the time into various modifications of our products to accomplish various things that are happening.

Mr. MARKS. Senator Pressler, let me respond and agree that indeed the development of new products has been quite extraordinary. The life cycles of complex data communications equipment have been decreasing, with new products coming on line very rapidly.

This is one where I guess advocates will take various positions. Let me cite an entity that is no friend of the restriction. The FCC constantly cites the competitive and innovation situation in CPE, in customer premise equipment, as the hallmark of its policies.

Mr. DEMAEYER. Senator, I would not disagree with their conclusions. I believe that the innovative world that surrounds that kind of telecommunications equipment that generally shows up at the desktop level of homes and businesses has in fact benefited greatly by the competition that was engendered by both earlier FCC rulings and the final consent decree.

But I would argue also that very little innovation and new service has come about in the national public network itself, that portion of the world that was once the crown jewel of telecommunications.

There has been very little innovation made there because the regional companies have had very little power with the very largest of manufacturers in getting them to do the work that is necessary, especially work that will allow us to be competitive with some of their own subsidiaries.

Our business interest will tend to focus on specific niche areas where we believe we need to be allowed to compete so that we can put those large companies to the proper competitive test.

I would reiterate again almost a total lack of desire on our part to try to become competitive in the CPE, customer premise marketplace. It is competitive enough. There are many players there and they do not need us.

Mr. SAMPSON. Senator, I am not sure that the latest Judge Greene ruling prevents research and development. I think in the description of manufacturing it really refers to design and so forth. I think probably pure research—

Mr. DEMAEYER. I would agree with that although, as my cable bracket example illustrates, pure research is not neatly separable from product design.

Senator PRESSLER. Maybe I should have asked this question to the last panel, and I will submit it to them in writing. I am also interested in telephone innovation in terms of what has improved there. But maybe this is out of the field of you three. Maybe I should have asked that of the last panel.

Do any of you want to address that, what innovations in the telephone area aside from the type of equipment that you talked about?

Mr. SAMPSON. In the telephones or the connections themselves?

Senator PRESSLER. In the telephones.

Mr. SAMPSON. I would say in our own case we have a neat little key system that is this long, maybe eight or ten inches long, three or four inches each way. It does five times as much as what the one sitting on my desk that was made by a Japanese firm. Extremely good piece of equipment, but it is about one-third of the size, something we are marketing.

I think there are lots of new products. I know as far as the way things are connected—and this is our business. The way they are connected, the way they are protected against environmental problems, whether it is in the difficult shoreline areas, we have made tremendous strides in the last few years in the way our products are made.

And I think all of the USTSA members have really had to button down and improve some of their manufacturing processes in order to sell to the RBOC's, because Western Electric was indeed a real leader in manufacturing technology. And it has been necessary for us to be as good as they are or try to be.

As a matter of fact, when our plants have been inspected, we have had people come to inspect them who had 26 years with Western Electric and they are the people that are coming to review. So we know we have to do it pretty well or we are not going to get approved.

Mr. MARKS. I do not know if this is responsive, because you may have in mind a broader or narrower class of equipment, but let us just throw a couple out. There have been significant price decreases and improvements in the quality of devices called modems, which are used on circuits to allow home PC's or business PC's or any kind of PC's to operate over telephone circuits.

Now, in the business area there has been tremendous improvement in cost and quality of devices called multiplexes, which are put on the customer premises and allow you to make more efficient use of the local loop. You can derive more lines out of the same piece of copper.

Senator PRESSLER. Has this been covered? If it has been covered in one of the statements, then I will read it in the record.

But why should not BOC's be allowed to enter joint ventures with alternative manufacturers to AT&T, where the engineering and network experts of that BOC would work with an independent manufacturer? Would not this type of arrangement increase competition among the equipment suppliers in a market now dominated by AT&T?

Mr. SAMPSON. Anyone that they enter into a joint venture with is going to raise the same issue. They are going to have competitors that are going to be excluded. There are certain ways that they can go into joint ventures, maybe even loaning money to someone who is trying to develop a product, or taking an investment position, take an equity position, participate in the development.

But if they do, they are going to be terribly biased on whether that product is the best or not, whatever. If they select it, that product for their use, it is probably going to be suspect and probably frowned on by someone who thinks they have a better product at a better price.

On the other hand, as I mentioned before, if the product is not as good and they select someone else's, who are they ever going to sell that one to?

Senator PRESSLER. Thank you very much, Mr. Chairman.

Senator INOUE. Thank you, Senator Pressler.

As I indicated, these oversight hearings on Judge Greene's modified final judgment and related matters will continue on next year. And tomorrow we will continue the hearings and cover information services.

Originally the committee announced that the hearings would begin at 9, but because of unexpected scheduling problems it will begin at 11 o'clock tomorrow morning in this room.

I would like to thank the three of you for participating in this afternoon's hearing. I have been advised that several members of the subcommittee would like to submit questions for your consideration and response. The record will be kept open. If you would like to modify your statements or supplement it, please feel free to do so.

Thank you very much.

Without objection, a letter from the chairman of the Subcommittee on Antitrust, Monopolies, and Business Rights of the Judiciary Committee, the Honorable Howard Metzenbaum, will be made part of the record.

If there is no further business, we will stand in recess until 11 o'clock tomorrow morning.

[Whereupon, at 4:48 p.m., the subcommittee was adjourned.]

MODIFIED FINAL JUDGMENT

FRIDAY, DECEMBER 11, 1987

U.S. SENATE,
SUBCOMMITTEE ON COMMUNICATIONS,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 11:10 a.m., in room SR-253, Russell Senate Office Building, Hon. Daniel Inouye, chairman of the subcommittee, presiding.

OPENING STATEMENT BY SENATOR INOUE

Senator INOUE. At yesterday's hearing, the subcommittee heard testimony on the long distance services and manufacturing restrictions in the MFJ. These were the two restrictions where Judge Greene reaffirmed the prohibition on entry by the Bell Operating Co.

This morning, we will hear testimony on information services restrictions.

On this matter, the terms of entry by the Bell operating companies are still being decided. The judge now has before him comments on the functions that the BOC's should be able to offer as part of the "gateway" services. I think that we can expect a decision from the judge sometime early next year.

There has been extensive discussion and speculation about the information services market in the United States. Judge Greene considered the development of this market elsewhere in the world, particularly in France, with its Minitel system, and premised his limited amendment of the information services restriction on the need to get this product to the American public.

There are many who believe the Judge, in permitting the Bell Operating Co. to offer "gateway" services did not go far enough in giving an impetus to the distribution of these services. Others believe that the reason why this market has not developed has little to do with the entry by the Bell Operating Co's. and more to do with the fact that the demand for such services simply does not exist.

I expect we will hear more on this debate today.

Finally, I can assure all that the subcommittee will permit further comment for the record, after the Judge's decision. In fact, as I indicated yesterday, these hearings will continue into next year to make certain that all parties who are involved and interested in the MFJ will be given an opportunity to participate.

For that matter, the record will be kept open, so that if any of you wishes to provide supplementary information or additional information, please feel free to do so.

With that, I welcome the panel this morning, which consists of: the vice president, Corporate Planning and Budget of Bell South, Mr. Sidney Boren; the executive vice president and general counsel of U.S. West, Mr. Laurence DeMuth, Jr.; the President and Publisher of Pottsville Republican, Mr. Uzal Martz, Jr.; the executive vice president of the Information Services Division of CompoServe, Inc., Mr. Maurice A. Cox; the legislative director of the Consumer Federation of America, Mr. Gene Kimmelman; and the vice president of Consumer Information Systems, Dun & Bradstreet Corp., Mr. Michael S. Field.

I want to thank all of you for taking the time to be with us today.

If I may, may I call upon Vice President Boren first.

**STATEMENT OF C. SIDNEY BOREN, VICE PRESIDENT,
CORPORATE PLANNING AND BUDGET, BELL SOUTH**

Mr. BOREN. Thank you very much, Mr. Chairman. I am Sid Boren, with the Bell South Corp.

I appreciate very much the opportunity to speak with you today about a subject that I consider to be quite important.

I am here today because, as a businessman and as a citizen, I am concerned about the future development of information age services. I am also concerned that this country is falling far behind Europe, Japan, and other parts of the world, especially as we enter a world economy driven by information, all of this taking place while our most crucial information age assets sit helplessly by, handicapped by a court order.

That is exactly what is happening.

Ironically, my company and six other companies in the same situation could do something about it. But we are not allowed to, and I hope I can convince you to share my concern.

First of all, there is a lot of public misconception about what information services the "baby Bells" can perform. The truth is, as you indicated just a moment ago, that up until now, we have been granted no relief from this restriction. The court is only now in the final stages of determining how and under what conditions we will be able to provide transport information.

Early signals are from the court that these conditions may be so restrictive that this country will be denied the full capability of the public telephone network. The court has also indicated that we cannot own any information passing through that network, thereby denying the public the benefit of the creative ability of seven of the most technically advanced companies in the country.

Second, parties involved in the original antitrust decree, which include AT&T and the Department of Justice, now agree that the modification of final judgment's information service restrictions have outlived whatever usefulness they may once have been imagined to have.

Thus, we have an interesting situation, where the court chooses not to change a consent decree, even when all parties involved either recommend or do not object to the changes.

My message this morning is very simple: Bell South wants, and I believe this country needs, a coherent, national information policy, shaped by the broadest long-term public interest. In fact, this country must have such a policy, and it is not in place today.

Unless something changes fast, the status quo I fear will prevail, and this country will be relegated to a second class position, as other countries, many of whose policies are driven toward the information age, will continue to pass us by.

Thus, already behind today, we will fall further behind in the future.

This is ironic, because telecommunications is one of the few areas where we still outpace the world in technology. Unfortunately, we have not yet adopted a national policy that will allow this expertise to be brought to bear on the problem.

Mr. Chairman, let me suggest what Bell South and the other Bells have to offer.

First, we have today, in service, a supremely valuable national resource with a potential that we think is going to waste. It is a state of the art, ubiquitous telephone network that is unmatched anywhere else in the world.

On the face of it, Bell South has the technical ability today to offer a fairly dazzling array of services to our average customers. I might note that that is of particular interest to those who cannot afford sophisticated equipment themselves, and of particular interest to those folks who live in small towns and rural America.

In addition, we have the ability to make the network do all the work that is needed to facilitate communications between customers and all information services providers, not only for the technology that is embodied in the terminals that are in the marketplace today, but for the technology that will be developed in the future.

Actually, I think our real contribution goes far beyond the specific information services that we might be able to offer. What we do have to offer is this: the unique ability to allow us to flourish, to cause to flourish a broad-based information services industry, one with thousands of players. This I think is a most relevant factor, and the fact that this resource is not being tapped today we think is a national catastrophe.

Only when useful, easy to use services can be delivered efficiently to millions of customers will the information age have truly arrived. Frankly, I don't think that will happen until the full power of America's telephone network is put to its full potential, a potential that is now suppressed, as you know, by policies driven by the assumption that, allowed in the business, we will squelch the information industry.

Mr. Chairman, I would like to close with a question.

In an age characterized by global information systems and growing concerns about America's place in that age, what conceivable national interest can be served by keeping seven of America's most technically competent companies out of the industry that they are uniquely equipped to serve?

Bell South's vision is an America where average citizens can and will dial up useful information and services as easy as they dial a telephone today, services ranging from home security to energy management, to health care, to pertinent data bases for small business and residential customers.

It is an ever-growing list of services that are being provided, limited only by the imagination of the people in this business.

The vision that I am talking about will not be accomplished in this decade or perhaps the next. But we must begin.

Mr. Chairman, what would I ask you to do about the problem? I request that you continue to keep yourself information on this issue, as you are doing today; that you continue to focus attention on the issue because of its significance in this country; that you watch carefully as events unfold over the next few months at the court and at the FCC.

My great fear is that judicial rulings over short-term concerns will prevent this country from fully participating in the information age. If you see that happen, then I believe you must do whatever is necessary to correct it.

If, in your judgment, that requires legislation, then, of course, I would support that.

Thank you very much.

[The statement follows:]

STATEMENT OF C. SIDNEY BOREN, VICE PRESIDENT, CORPORATE PLANNING AND
BUDGET, BELL SOUTH

Mr. Chairman and members of the Senate Communications Subcommittee, BellSouth Corporation welcomes this opportunity to address an issue of vital importance not only to its own well-being but also to that of our country. I am Sid Boren, Vice President, BellSouth Corporation, Atlanta, Georgia. The issues the Subcommittee is examining in these hearings have much to do with the long-term welfare of our nation, and BellSouth finds the prospects for information services in America's future both exciting and disturbing.

Exciting, because today we have opportunities to use the advanced tools of our advanced age -- tools which already exist -- to a unique national competitive advantage, if allowed to by the Court. It is no exaggeration to say the so-called information age, properly addressed, is the most compelling strategic opportunity our nation has for improving its competitive position in international trade.

But disturbing, too, because of certain voices in the public debate shaping our information policy. If the United States were merely oblivious to our opportunities, then perhaps a call to action would suffice. Unfortunately, the situation is far more grave. This country has been set down a course clearly designed to serve short-term interests -- but no one well in the long term.

Let us be specific. Early this year, BellSouth filed with the United States District Court in Washington, D.C., a request for removal of all restrictions on our ability to provide information services to the American public -- a subject of considerable public misconception, because the popular press initially described what we're allowed to do in grossly exaggerated and misleading terms.

Other parties, including the Department of Justice and the remaining Bell companies, also urged the courts to lift the outdated restrictions, and AT&T did not oppose our requests. Indeed, all parties recognized that information services were never the subject of the government's allegations in the antitrust suit against AT&T. Further, parties to the original decree, including AT&T and the Department of Justice, now acknowledge the Modification of Final Judgment information service restrictions have outlived whatever usefulness they may once have been imagined to have. As you know, the court still has not issued a final ruling on this matter of information services. But wording in the court's recent decisions is not encouraging.

Instead of taking a bold step into an age characterized by widespread public access to advanced networks offering useful information to average Americans, the Court seems instead to have directed the U.S. information service industry down a twisted path of Byzantine rules sure to stifle rather than nurture its spread to homes and small businesses across the nation.

BellSouth does not appear before this Subcommittee today merely to condemn the course some have attempted to set for this nation. Instead, we would like to present an alternate, more fruitful course.

It's a course demanding a sense of vision and the strength of purpose to carry that vision forward. And it's a course demanding a long-term view. BellSouth's concerns are not only what services are brought to the public today, but also what this nation will require before the turn of the century to transform itself into an information-based economy, where Americans in the average home and business can retrieve and manipulate written information as casually and usefully as they use the telephone to transmit verbal information today.

America cannot make this transformation overnight, or even in the next five years. But we must take the first steps now to set the stage for that transformation to come. In short, it's going to require the full participation and commitment of American companies of all sizes to provide the necessary infrastructure... to design content and services which people perceive as useful... to develop and make available affordable terminals... and to bring the information age to all Americans -- and this simply cannot be done unless the Bell companies are brought in as full participants. Without a strong element of network participation... without the network's great strength of ubiquity... the full diversity of independent entrepreneurial imagination in this country will remain untapped for the greatest public good.

How can America shape a coherent, intelligent information policy for the greatest public good? In a number of ways.

One way would be for the Congress to declare, through whatever means it deems appropriate, that it will exercise its role as the policymaking branch of government... and that this matter of a cogent information policy is far too fundamental and important to this country to be left to judicial or regulatory processes.

The Congress could exert this leadership in several ways. First, by taking the matter of jurisdiction over information services out of the court's hands by overriding the Modification of Final Judgment as it pertains to information services.

Second, by sending an unmistakably clear message to the FCC that it strongly intends the FCC to allow the maximum amount of information to be offered to the maximum number of Americans in the minimum amount of time.

Third, by recognizing the Bell companies have a vital role to play not only as one of the distribution channels of information, but also, in some cases, as one of many content providers, with the emphasis on "one of many." Other distribution channels include daily and weekly newspapers, magazines, television, radio, cable TV, books and billboards -- to name just a few.

This is simply one scenario describing a possible road to a sound information policy driven by the greatest public good. BellSouth appears here today to encourage the Congress to take whatever action it deems necessary to bring these services to the public. We want to make clear, though, that however America chooses to shape its information policy -- by action or inaction -- BellSouth's desire is to see as many information sources as possible develop and prosper. We want to be among the suppliers of content, and we believe we have databases -- electronic Yellow Pages, for example -- attractive enough to encourage the general public to use the system.

But BellSouth -- or any single company -- lacks the resources or skills to handle all the public's information needs. We, like all involved, are best served by the largest possible pool of database service providers. We would be happy to see this pool grow day by day, because such growth would more fully utilize a public resource that holds tremendous potential for delivering a fertile information services industry into the average American home. More participants mean greater economies of scale, and this in turn means economic incentive for even more participation from new information service providers -- including small entrepreneurs with fresh ideas attractive to still more people. We want average Americans to have at their fingertips everything from home security and environmental systems... to health care and elderly-help information... to data bases geared toward small business... to the local Little League standings for their sons' and daughters' teams. Technically, those capabilities are almost immediately within our grasp, as BellSouth's demonstration at the Chicago Information Industry Association annual meeting last month clearly suggests.

But the court decree blocks these capabilities from becoming reality. To make them real, we need the freedom to build a hospitable environment not only for the giants of the information industry, but also for the entrepreneur who has only an idea and a shoestring budget. We want to build an

information industry greenhouse where ideas can germinate and grow and take strong root. We want to have an information resource so rich it will change people's lives abundantly for the better. Our vision is an America where retrieving boundless, useful information is as easy as making a phone call.

The French had a similar vision years ago, and planted a seed which today is the Teletel system, equipped with the Minitel terminal. The French are to be congratulated for what they have done. Given the state of technology when their system was designed, it was a good match to their needs -- which was basically to replace a white-pages telephone directory with an electronic one. But in the years since the French made their design decision, the state of the art of technology has moved forward dramatically.

The French system should be a stimulus -- but not a model -- for us. It should stir our national pride to regain the leadership role in the vital area of information services. But if we listen to those voices telling us to replicate the French system here, we would be saying "me too" to technology long obsolete.

Instead, we should take the French experience as a starting block and look ahead. The world has moved too far and the opportunities are too great for our nation to willfully shoehorn ourselves into obsolete technology. Our nation's network in fact should be designed to accommodate all types of terminals, from the smartest to the dumbest, and not be limited by the characteristics of any particular device, and certainly not the Minitel terminal.

We should also look beyond the pedestrian telephone network used by Teletel. Despite advocates who shroud the issue with calls to keep communications "transparent" and protocol conversions at "low levels" or at the "minimum necessary," we believe the national interest would be poorly served by aiming our telephone industry's architecture at far too low a denominator. Obviously, the primary interests being served by advocating this approach are the self-interests of proponents of the status quo.

There is another question begging Congressional attention here. Should telephone companies be allowed to provide information content? The conclusions expressed in the court's September 10 memorandum are to allow entry into electronic white pages, but not electronic yellow pages.

Put bluntly, we believe this to be a blatant example of yielding to special-interest pressure. It is a sad day indeed when a court of law becomes the scene of political expediency. The antitrust laws which were designed to promote competition are being stood on their head and used to prevent competition. These special interests wrap their arguments in First Amendment rhetoric, but the truth is the document they wish to protect is not the Bill of Rights, but the profit statement of their business.

To date, BellSouth has never participated in the provision of information content. Yet, in spite of this abstinence, it's presumed we're untrustworthy to participate in the information content business because of unproven allegations of imagined, potential offenses.

We believe that presumption penalizes the average American. Just as routinely as we currently offer E-911 emergency service under court waiver, we could -- if allowed -- offer medication- or appointment-reminder calls, message services or mass calling -- such as the Congressional beeper service alerting members to floor action. Those services could all be handled by phone company computers for companies and individuals who can't justify the cost of buying the required sophisticated equipment.

What conceivable national purpose is served by keeping information services restricted only to those who can afford sophisticated equipment? What conceivable national purpose is being served by keeping seven of America's strongest, most technically astute companies shackled? Is our nation's strength in the competitive fields of international trade, technological innovation and overall world leadership so great that we can afford the luxury of keeping these companies in a penalty box for fear of imagined perpetrations? The truth is, we -- the Bell companies -- can be welcome wellsprings of innovation, a formidable national resource, if we are simply allowed to contribute.

The information market has vast reserves of untapped potential, and there is room for all -- including BellSouth, the other Bell companies, and many, many other players -- to participate in its development and growth.

But that growth will come only if the available technology of the telephone network is used to its fullest potential... a potential now suppressed by a Court which believes we will squash a business that in fact has had great difficulty taking root and without our participation may never take root and grow in America.

For only when useful, easy-to-use services can be delivered efficiently to large numbers of homes and businesses will the market's growth potential be realized. When, and if, it does, capable companies will all share in and contribute to the market's growth.

It's true that in a fully mature market, competitors win only when another loses. But in a growing market such as information services, everyone can win.

Does that mean everyone will win? No, because the information business is complex and mercurial. Skillful companies adapting quickly to the changing needs of the market will win, and others will fail. But in the process, consumers individually, and the nation collectively, will benefit greatly.

Therefore, BellSouth should have the freedom and opportunity to make business decisions we believe to be in the interest of our customers. We are prepared to accept the business risks and rewards that go with those decisions. In short, we would like the freedom to try. And if we fail, we want it to be because of our abilities, or lack thereof -- not because the game is rigged by an illogical set of rules.

Mr. Chairman, in summary, BellSouth has come before you to seek your help. Help not only for our company, but also for the supreme special interest -- that of our country. For in fact this is how we all should view the subject of a national information policy: What is in the best long-term interest of America?

BellSouth thanks you and the members of your committee for giving us this opportunity to express our concerns and to state what we believe are rational approaches to our national concerns. Our hope is that as the members of this Subcommittee, and, we hope, the full membership of Congress, deliberate these issues in the days ahead, you will reflect on the questions of fairness, national interest and individual consumer interest raised here today. BellSouth is committed to do all we can under any set of rules we are required to operate under. But our contribution to the consumers of this nation, both large and small, will never be maximized as long as we are bound by arbitrary, unwarranted restrictions.

Thank you for hearing our voice on this vital issue.

Senator INOUE. Thank you very much, Mr. Boren. As to your last question, I am certain the other witnesses would be very happy to respond to that.

But before we ask questions, we would like to hear from all of you.

So our next witness is Mr. DeMuth, executive vice president and general counsel of U.S. West. Would you take the microphone, please.

**STATEMENT OF LAURENCE W. DeMUTH, JR., EXECUTIVE VICE
PRESIDENT, GENERAL COUNSEL, AND SECRETARY, U.S. WEST**

Mr. DeMUTH. Thank you, Mr. Chairman, Senator Packwood, and members of the committee.

You have correctly identified me. I am the Executive vice president, general counsel and secretary of U.S. West. I am Laurence W. DeMuth, Jr.

I represent a diversified telecommunications company based in Englewood, CO. I am pleased to be having the opportunity to testify before this committee and before you gentlemen.

We need to remove the AT&T consent decree line of business restrictions. That removal is critical to the company I represent, to this Nation, and to the industry. The restrictions in the MFJ address a decade long gone, the decade of the seventies. They are inappropriate and obsolete. Each contains its own special flaws. But, most significantly, the information services restriction has and continues to handicap this Nation as an information age leader.

We have the technology. We have the information and the data. We have the economic capability, and we have the need to participate in the information age.

Yet, the average American cannot access the great data resources or receive the services which would add cultural, practical and social dimensions to all of our lives. The primary obstacle to changing this situation is the modification of final judgment and the resulting inability of the divested Bell Telephone Cos. to respond to the reality of the present.

In January of next year, the MFJ will celebrate its sixth anniversary, and the Huber report will be almost a year old.

Yet, the only sign that necessary changes in the MFJ are going to occur is the language in Judge Greene's holding of last September 10, that he is willing to listen to the idea that the divested local exchange companies can provide "gateway" functions essential to allowing all Americans access to the electronic information that will improve our standard of living and add to our general well-being.

During the triennial review of the MFJ, there was, and still is, a consensus that the proposed loosening of the decree by the judge is not enough. Even the Department of Justice in its report to the court agreed that the divested companies need more information service ability. The court did not agree, and took this much narrower view of what is necessary to further this country's progress into the information technology.

Given the court's order and the limited nature of the potential judicial concession with respect to the information service restraints, the proposal made recently by the American Newspaper Publishers Association, by U.S. West and by others is a significant step forward for the American public and our economy.

The proposal of the company which I represent and the organization which Mr. Martz represents and others is an effort on the part of those who understand that it is important to act and to act now. Progress, even within the narrow limits of the proposal before the court, is possible and essential. At a minimum, the barriers which prohibit the diversified companies from helping the information

providers reach consumers will have to be lifted, so that they may all benefit from the technology that other foreign countries and the consumers in other foreign countries are already utilizing so effectively.

The provision of "gateway" functions by the common carrier utility will not only expand the world of information available to all at a price that all can afford, but it will also enable the average American to create his or her own data bases. No one will then need to be out of touch.

The teenager can simply store the fact that he or she will be an hour late, and the aged and the infirm will now have new opportunities for security and for a sense of wellbeing. Nor will anyone need to be a computer expert to realize that if these benefits can be provided by access over the public network owned and operated by the divested companies.

Now, others will make the case for removal of all the MFJ restrictions, and yesterday you heard some of those others. We add our support to the case for the complete removal of all restrictions.

Our point is that within the context of where we are today, everyone—Congress, the regulators, the executive branch and the decree court—must join in recognition that the policy of restriction and interference will not lead this Nation into the information age.

Now is the time to free the companies which provide and operate the facilities which constitute the infrastructure of communications within this Nation to expand the capability of those facilities.

U.S. West supports the removal of all three line of business restrictions contained in the decree negotiated by AT&T and the Department of Justice, and modified by the decree court. In particular, however, the information services restriction should be immediately removed, as has been recommended by the decree court and by the parties to this decree.

Thank you, sir.

[The statement follows:]

STATEMENT OF LAURENCE W. DEMUTH, JR., ON BEHALF OF U.S. WEST

I am Laurence W. DeMuth, Jr., Executive Vice President, General Counsel and Secretary for US WEST, a diversified telecommunications firm based in Englewood, Colorado. I am pleased for the opportunity to testify before the Subcommittee on Communications today because removal of the AT&T Consent Decree line of business restrictions is critical to my company.

Although the purpose of this panel is to discuss the information services restriction contained in the Modified Final Judgment, it is important to note that there is consensus among all affected parties—that is, the Regional Holding companies of which US WEST is one—that all of the line of business restrictions must be removed.

In the 1982 Order creating the Modification of Final Judgment, the Court, for the most part, accepted an agreement which had been arrived at between the Department of Justice and AT&T. The Judge, however, insisted on an additional provision: removal of the restrictions imposed on the divested companies upon a proper showing. Under this provision, the three core restrictions (on information services, on manufacturing and marketing telecommunications equipment, and on provision of interexchange service) are to be eliminated upon a showing that there is "no substantial possibility" that the petitioning Bell operating companies can impede competition in the market or markets to be entered. The Court also ordered a review of the continued need for the restrictions every three years.

Five years later, on September 10, 1987, the Court after an extensive review denied any relief from the manufacturing and interexchange restrictions. The Court did remove the restriction denying the Bell companies the right to enter into any

non-telecommunications lawful business; and, in addition, agreed to allow the divested BOCs to perform transport functions for information services.

In the years since divestiture, the Court has refused to permit the BOCs to enter the three businesses which are closest to their exchange activities. Thus, paradoxically, the BOCs have been forced to diversify into businesses which are not naturally related to their technological and business expertise. US West submitted a substantial volume of sworn factual and expert evidence to the Court as part of the first review of the MFJ to show that, because of this, the nation's telecommunications markets have not received the full benefits contemplated at the time of divestiture. The telecommunications market is not enjoying the full, active competition which is a fundamental purpose of divestiture. Rather, the natural strengths of the Bell companies and the talents of their employees have been kept in check with the result that consumers have fewer choices and pay higher prices for telecommunications and information products and services.

US WEST has not suggested to the Court that divestiture was a mistake, or that the restrictions were a bad idea when they were imposed. Rather, US WEST has shown, consistent with the prediction of the Decree, that the restrictions are no longer needed. US WEST has also shown that some of the Court's 1982 forecasts about how competition would develop (based on representations made by AT&T and the Department) have not been fulfilled.

US WEST has also not suggested that the Decree court simply abdicate its anti-trust responsibilities to the FCC. US WEST believes there will be no competitive harm from the entry of the Bell operating companies into the three prohibited markets. Where regulation is a relevant factor, it is as a safeguard, with a limited and specifically defined role to play. US WEST believes the Decree court should no more be doing the regulators' job than the regulators should be doing the Decree court's job. Under the separation of powers of our federal system, each entity has its place and each entity has more than enough responsibilities to execute without trying to do another entity's job.

INFORMATION SERVICES: A DEFINITION WITHOUT A REASON

The government presented no evidence of abuse as to information services by AT&T or the operating companies during the 1981 trial. The Court acknowledged this and accepted what the Department has called an argument by analogy. This seemed appropriate because there were no information services to speak of at the time and therefore the existence of possible abuses was conjectural. The Court did assume that if the Bell companies were kept out of information services businesses they would have the incentive to enhance their networks to make it easier for others to provide information services.

Unfortunately, five years later, there are no universally, easily accessible information services in the United States. This is not the case in other countries, most notably France. In France, over 4,000 information services are available to 2.2 million subscribers over an inexpensive (less than \$200), simple terminal. France is a less affluent country than our own, with a population only one-fifth that of the United States. The Teletel system has succeeded as part of the French telephone company, which financed the entire system without any taxpayer money, and will recoup its investment by 1990 or 1991. (In contrast, United States systems of this nature have fewer than 750,000 subscribers and provide many fewer services than are available in France. In America, subscribers must own relatively expensive home computers, modems and other interfaces, and be computer literate. The subscribers to one of the larger services have an average income of \$43,000.) The French system was on the technological edge in the 1970s. Technology has moved beyond their system. But their experience demonstrates that a market exists for widely based information services and France has met that need.

US WEST asserts, together with concerned minority groups which have urged the Court to remove the restriction, that the United States is in danger of being divided between the information-rich and the information-poor. Unless the Bell company networks are effectively utilized in bringing information services to the mass market, information services will continue to be available only to the affluent. The Bell companies must be permitted to provide for new data services the same kind of ubiquity that they provide for voice service.

The existing decree prevents this. The problem is the definition of information services. The scope of this definition is very little understood even among the small group of lawyers who practice before the Decree court. The Decree prohibits the Bell operating companies from going into media businesses, and from providing all manner of information to consumers. But it does far more than this: it prevents the Bell companies from using their networks to facilitate machines talking to one an-

other. A WANG personal computer and APPLE personal computer cannot communicate over the telephone network today without expensive hardware and software interfaces. The information services definition in the Decree specifically prohibits the Bell companies from using their networks to solve this dilemma. The information services definition also specifically prohibits the BOCs from providing to videotex service providers the network functions that are essential to serve the mass market for videotex services. This restriction blocks the creation of the type of service which the French Teletel system performs.

Earlier this year, U S WEST asked the Court to remove the entire information services ban, including the restriction on providing information content. It is fundamentally inconsistent with First Amendment values to restrict the Bell companies' right to provide information, like other firms and individuals. Even if some restriction is necessary, the restriction on providing information should not be absolute; but, rather, it should be the minimum necessary to prevent abuse by the Bell companies. With this in mind, U S WEST contended that it would be appropriate for the court to require that Bell company-provided information (i.e., "content") be provided only through a separate subsidiary which would deal with the operating companies themselves on a non-discriminatory basis.

In contrast to information services content, the Bell companies' use of their networks to facilitate the transport of data between machines cannot practicably be done through separate subsidiaries. Such a restriction would only serve to preclude the economies which the operating companies uniquely can realize in bringing these services to the public by integrating the necessary translation functions into their networks. In its September 10, 1987 Order, the Court recognized that the information services restriction contained in the MFJ was harmful to the interests of America and agreed that it is necessary that the BOCs be allowed to perform transport and other functions with the MFJ today prohibits. The Court is currently considering what specific functions should be allowed.

While U.S. WEST is pleased that the Court has recognized the fact that the MFJ harms America's interests, U.S. WEST is not pleased that the Court believes only the Court should be vested with the power to decide the most minute technical and public policy issues. This Congress, and the agencies it has created, should determine such issues—not one judge with virtually no staff or expertise other than evidence heard more than six years ago.

U.S. WEST and the American Newspaper Publishers Association submitted a joint proposed order to the Court that would allow the nation's telephone companies and information service providers to work together to begin to bring the information age to America. Congress should carefully monitor what the Court decides in the current proceeding to ensure that the Court's desire to restrict the BOCs does not continue to also restrict the right of the American people to enjoy the numerous benefits which accrue from access to information.

MANUFACTURING: FREEING THE TELEPHONE NETWORK FROM AN EXISTING CARTEL

The AT&T Consent Decree barred the BOCs from manufacturing or marketing telecommunications equipment. The only exception to this broad prohibition is the right to sell, but not make, customer premises equipment. The government offered trial evidence in 1981 that AT&T had directed the BOCs to make preferential buying decisions in favor of AT&T's manufacturing company. The government said that the BOCs had complied and that as a result BOC networks had very little equipment provided by other firms. The Decree's solution to a recurrence of this problem was to keep any operating company-affiliated enterprise out of the business of making parts for the network.

Experience has shown, however, that the Decree did not address adequately the critical matter of breaking the Bell companies' existing dependence on Western Electric (now AT&T Technologies). A number of regions are still largely dependent on AT&T for their major switching and transmission systems. There is only one significant entrant into the central office switch market which has had any success in competing with AT&T.

To the extent that the present market permits, U.S. WEST has been aggressive in diversifying its source of supply. However, it finds itself at the mercy of two large firms for modern switches. If those firms do not choose to meet a need of U.S. WEST's customers, U.S. WEST is precluded from helping another manufacturer to do so. For example, in its largely rural serving area, there are many electro-mechanical switches which cannot be presently converted to equal access as required by the Decree. It would be very costly for its ratepayers if U.S. WEST operating companies were to abandon these electro-mechanical switches and install new electronic machines. U.S. WEST asked AT&T to develop an adjunct processor which,

when used with the older machines, could provide equal access to AT&T and its long distance competitors. AT&T had other priorities for its manufacturing expertise, and declined. Only one small firm could be found to undertake this work, and U.S. WEST's experience with that effort has been entirely satisfactory.

What the effort with the independent manufacturer of adjunct devices lacked was a closer involvement by U.S. WEST's engineering and network experts. Those experts have the know-how to solve the many equipment design issues integral to the development of advanced technology applications. However, under the Decree, U.S. WEST may not engage in a joint venture with another firm to solve these technological problems and U.S. WEST may not capture for its ratepayers and shareholders the benefits of the contribution by those employees to the manufactured product.

In an effort to improve the technology used to provide exchange services, U.S. WEST announced this fall that it was going to build a scientific research facility employing as many as 1500 people near Boulder, Colorado. When U.S. WEST's plans became known, AT&T appealed to Judge Greene to stop U.S. WEST and all BOCs from engaging in research and development of telecommunications equipment and products. In an order issued only eight days ago, Judge Greene gave AT&T what it wanted and barred the BOCs from design and development of telecommunications equipment. Incredibly, the Court appears to have also barred the BOCs from the creation of software for their own switches. This order, if upheld, would make U.S. WEST and the other regional companies even more totally dependent upon a single supplier—AT&T.

The Congress should hold additional hearings on the Decree Court's recent orders to determine the impact of those actions on America's ability to compete with the rest of the world in high-technology telecommunications products and services. If the 500,000 men and women of the BOCs cannot put their knowledge and experience to work in the creation of new ideas for new and better ways of providing telecommunications, America will be permanently harmed.

U.S. WEST has no desire to launch a full-scale manufacturing effort. Instead, it desires the flexibility to participate in joint ventures to assure that products its customers need are available in a timely and cost-effective way.

Substantial economic analysis has been presented to the Decree court which shows that the market shares of the Bell companies individually, if they were permitted to manufacture, would be inconsequential when measured against those of the mammoth firms now in the market. Each of these firms is affiliated with a telecommunications carrier already. Bell company participation in these markets would produce a competitive alternative to keep these dominant firms efficient and responsive.

THE INTEREXCHANGE MARKET: WHERE IS THE COMPETITION DIVESTITURE WAS DESIGNED TO PRODUCE?

The AT&T Consent Decree bars Bell company participation in the interexchange business with the purpose of avoiding the kind of preferential arrangements favoring an affiliated interexchange carrier found in the old Bell System. This restriction was thought to be necessary to permit competition in the interexchange market to flourish. Unfortunately, competition has not flourished. AT&T has an 80 percent market share, which appears to be growing. Many resellers and other interexchange carriers are in financial trouble as AT&T drops its prices and MCI and Sprint follow suit. Now MCI, in a dramatic turn, has announced that it wants AT&T deregulated. The effect of this action, of course, would be to permit AT&T and then MCI to raise their prices. Thus, the largest interexchange carriers would have a comfortably-managed cartel. US WEST asserts that the nation did not endure the pain and vast expense of divestiture to achieve that kind of market.

The divested BOCs are uniquely able to provide competitive balance against AT&T's enormous market strength. US WEST has no desire to create a nationwide replica of the old Bell System. It does, however, want to serve its very largest customers who, right now, have alternative means of access to long distance carriers—including access through recently implemented AT&T services. The Decree permits AT&T and other carriers to be one-stop shopping centers for customers' communications needs. Interexchange carriers can resell exchange company services and provide customer premises equipment. The Decree, as interpreted, prevents the BOCs from reselling interexchange service. There is, therefore, a complete lack of competitive parity. The interexchange restriction must be abolished if that condition is to be corrected.

US WEST has also made a substantial showing that, as a matter of fact, it has less capability of monopolizing interexchange business in its territory than the GTE

operating companies had when GTE acquired the Sprint network. Judge Greene permitted that acquisition, even though it meant common ownership between exchange carriers and an interexchange carrier. He accepted the government's argument that such common ownership was not a competitive problem because the GTE operating companies' service areas were "rural and dispersed." Both terms just as accurately characterize US WEST's companies. US WEST's companies serve fewer lines per square mile on the average than GTE, and GTE's access lines generate over 50 percent more interstate access revenues than do US WEST's.

US WEST therefore asks that it be premitted to do what GTE was allowed to do, namely, to provide interexchange service through a separate subsidiary dealing at arm's length with US WEST's telephone companies. Through this structure US WEST's telephone companies would provide equal access to all US WEST and other interexchange carriers.

CONCLUSION

In conclusion, US WEST supports the removal of all three line of business restrictions contained in the Decree negotiated by AT&T and the Department of Justice and modified by the Decree Court. In particular, the information services restriction should be immediately removed as has been recommended to the Decree Court by all the parties to the Decree.

[The following information was subsequently received for the record:]

U S WEST, Inc.
Suite 700
1020 Nineteenth Street, NW
Washington, DC 20036
202 429-3100

H. Laird Walker
Vice President-Federal Relations

USWEST

February 25, 1988

Ms. Regina Keeney
Minority Staff Counsel
United States Senate
Committee on Commerce, Science
and Transportation
Washington, DC 20510-6125

Re: Senator Pressler's Questions

Dear Ms. Keeney:

You have requested clarification of U S WEST's position concerning what types of information services it could provide if its proposed Order submitted with the ANPA to Judge Greene was accepted, and what regulatory system would result in the earliest availability of comprehensive information services to rural areas, with particular concern to South Dakota.

In responding to your inquiry on behalf of Senator Pressler, I assume you have by now seen a copy of our proposed Order. On the chance that you have not, I have enclosed a copy for your convenience and review.

Our position is that U S WEST, and by implication the other divested regions, should be able to do whatever is necessary to facilitate end users and third party providers ability to get together and exchange information. While we have delineated a number of examples within the proposed Order of what that could mean, we did not intend those examples to be limiting, because we recognize it is virtually impossible for any definition of an information service to be current beyond the date it is actually drafted, see for example Computer Inquiry I or II.

Therefore, we mean by our more generic statement to you that if it takes internal network protocol conversions, or billing, or the connection of disparate technologies and data systems to permit an end user and a third party provider to get together, then we want to be able to do that. It is very clear that today, while we can

Ms. Regina Kinney
February 25, 1988
Page Two

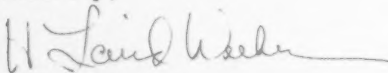
provide essentially most of the functions we have listed in the proposed Order for the underlying network for voice grade circuits for local exchange telecommunications, we cannot do so for what are defined as information services.

With respect to your concern about what regulatory system would result in the earliest availability of comprehensive information services to rural areas, there is no easy answer. Without some clear national level direction as to what we can provide, we currently must deal with the FCC, 14 state jurisdictions, the Department of Justice, and Judge Greene. It would obviously be much easier to make necessary proposed service improvement and capital investment decisions if we only had to comply with 1 set of rules, rather than 17.

With respect to your specific inquiry concerning South Dakota, I can only advise you that we are presently actively planning what we will be in a position to do once Judge Greene acts and we are aware of what type of information pathway we can, in fact, provide. As I stated at the outset, we are interested in developing and providing the ability for end users and third party providers to communicate. We are also interested in deploying such an ability as soon as we can, consistent with market demand and capital requirements. If we are permitted to provide service on the basis we indicated, rural South Dakotans would find information providers who currently may have available agricultural and other programs working with U S WEST to reach potential consumers as quickly as we can reasonably do so. This would certainly be consistent with the French experience, where agricultural programs were some of the earliest offerings. It would also be consistent with the fact that a very large part of our 14 state service area is rural.

If you have any other questions or would like any additional clarification, please do not hesitate to contact me.

Sincerely,



H. Laird Walker
Vice President - Federal Relations

Enclosure 1/

1/ The enclosure was not reproducible.

Senator INOUE. Thank you very much, sir.

Our next witness is the president and publisher of the Pottsville Republican, Mr. Martz.

STATEMENT OF UZAL H. MARTZ, JR., PRESIDENT AND PUBLISHER, POTTSVILLE REPUBLICAN, REPRESENTING THE AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION

Mr. MARTZ. Mr. Chairman, members of the subcommittee, I appreciate the opportunity to appear before you today to present the views of the American Newspaper Publishers Association.

I want to commend the committee for its continuing, careful oversight of telecommunications policy and the MFJ. Both the MFJ itself and the more recent September 10 decision bear the imprint of the legislative history supporting the diversity principle going back to S. 898.

This morning, I would like to summarize three key points which are detailed in our written testimony.

First, there has been no change in the basis for concern about the ability and the incentive of regional companies to discriminate against competing information providers. The same concerns which were so well documented during the extensive legislative and judicial review which led to divestiture continue with us today.

The regional companies still retain the same degree of monopoly control of those bottleneck, local exchange facilities upon which any electronic publisher is dependent for distribution of his services.

Sound antitrust and first amendment considerations continue to dictate that the regional companies should not be allowed to own or control the information flowing over those facilities.

This separation of conduit from content is the heart of the diversity principle, and is necessary to limit regional company anticompetitive behavior and allow for a diversity of electronic publishing sources.

Judge Greene incorporated this diversity principle into the MFJ and reaffirmed it in his September 10 decision.

The second point which I think is important for the Subcommittee to consider is the following. The French Minitel system illustrates that it is possible for consumers, for information service providers, and for the telephone company to all benefit if the telephone company provides the infrastructure and leaves the provision of electronic information sources to others, and, in the process, limiting the potential for anticompetitive conduct and fostering the diversity of information sources.

The French equivalent of our phone company, the DGT, concentrated on developing an infrastructure to service the needs of the information service providers, rather than on trying to compete with them. Today in France, there are more than 5,000 information service providers serving three million consumers.

Now, we don't have an infrastructure in this country comparable to the French Minitel. But our electronic publishing marketplace has developed to the point where the U.S. is a leader in the types and services offered and technological capability.

Admittedly, consumer penetration has been disappointingly low if for no other reason than because the complicated access and usage requirements tend to limit the appeal of these services to all but the most dedicated users because of the lack of this infrastructure.

Judge Greene's September 10 order envisions the development of an infrastructure which is designed to help spur the increased consumer use of these services, and we think that is the right approach.

The third point which I think is important to note is that Judge Greene's order lifting the restrictions on regional company provision of certain "gateway" services provides a predictable and well defined set of ground rules that hopefully will spark the accelerated growth of electronic publishing services in the United States. The ANPA-U.S. West joint order stands as unique evidence that within the confines of Judge Greene's September 10 decision, there is a viable starting place for this growth to happen.

This order is the result of a lot of hard work, to take the interests of the public and other interested parties to heart, and we believe that it strikes a useful, but appropriately cautious, balance between the regional companies and information service providers.

This balance is reflected in the fact that the comprehensive "gateway" functionalities that are included in it are the result of discussions with the French Minitel system, with other information providers and other regional companies, while at the same time including important safeguards, such as nondiscrimination and unbundling requirements, so as to minimize the potential for anticompetitive behavior.

Mr. Chairman, we are encouraged by the prospects for growth of the information services market that are envisioned in Judge Greene's decision and incorporated into our proposed order. It is a good place to start, it is at the right time, and it is the right pace.

We thank you for this opportunity.

[The statement follows:]

STATEMENT OF UZAL H. MARTZ, JR., PRESIDENT AND PUBLISHER, POTTSVILLE REPUBLICAN, POTTSVILLE, PA, CHAIRMAN, ANPA DIVERSITY PRINCIPLE TASK FORCE, REPRESENTING THE AMERICAN NEWSPAPER PUBLISHERS ASSOCIATION

Mr. Chairman, members of the Subcommittee, I appreciate the opportunity to appear before you today to present the views of the American Newspaper Publishers Association on the AT&T Divestiture, particularly the Modified Final Judgment (MFJ) information services restriction and Judge Greene's September 10 decision.

The American Newspaper Publishers Association represents approximately 1400 newspapers, accounting for more than 90 percent of the daily and Sunday circulation in the United States. Many non-daily newspapers also are members.

I want to commend the Subcommittee and full Committee for its continuing careful oversight of telecommunications policy and the MFJ. The Diversity Principle that ANPA espouses was acknowledged by the Senate when it passed S 898, the Telecommunications Competition and Deregulation Act of 1981. This important public policy was reaffirmed last year in the Danforth amendments to S 2565, the Federal Telecommunications Policy Act of 1986. Both the MFJ itself and the more recent September 10 decision bear the imprint of the legislative history supporting the Diversity Principle.

Mr. Chairman, ANPA members advocate a competitive and diverse electronic publishing market - electronic publishing being a submarket of the broader information services market. News, political views and information, editorial views, advertising, product and service information, many financial services, educational material, transactional services, sports reports and religious information and views, in either voice or data form -- all fall within the definition of electronic publishing.

In brief, we are pleased with Judge Greene's September 10 decision. It provides an exciting opportunity for the development of more diverse electronic publishing services to meet the needs of consumers and others.

Sound antitrust and First Amendment considerations dictate that monopoly telephone companies should not own or control the information carried over their bottleneck local exchange facilities. The separation of content and conduit allows for the development of a diversity of electronic publishing services, by limiting anti-competitive behavior. This Diversity Principle, based on the First Amendment value of maximizing the diversity of information services, was incorporated into the Modified Final Judgment.

In his September 10 decision, Judge Greene again recognized that in addition to competitive concerns, total removal of the information services restriction would pose a threat to First Amendment values. The Court stated:

it is the purpose of the First Amendment to achieve "the widest possible dissemination of information from diverse and antagonistic sources."

citing Associated Press v. United States, 326 U.S. 1, 20 (1945). The Court again found that the Regional Bell Operating Companies (regional companies) could use their control of the local exchange to reduce or eliminate competition in electronic publishing.

The Court's September 10 decision would allow the regional companies to provide limited gateway functions, but would preclude them from offering content-based services. We think this is the right balance, provided proper safeguards are established.

A cooperative situation in France, which has pursued a policy very close to our Diversity Principle, has led to the development there of mass market

videotex services. Regional company provision of gateway services in this country may help electronic publishing products reach a greater number of consumers.

ANPA and U S West October 15 submitted identical proposed orders to implement Judge Greene's decision. ANPA's goal in arriving at a common order with U S West was to create an environment in which the regional companies would provide the access services needed to allow information services to flourish. The common filing reflects the newspaper business' commitment to the creation of an infrastructure to speed the further development of electronic information services. The National Association of Broadcasters, the National Newspaper Association and the Magazine Publishers of America also supported the ANPA/U S West proposed order.

Under the ANPA/U S West proposed order, the regional companies could provide a gateway for information services to be offered by others. These gateway functions would include: a central telephone number to make it easier for consumers to access these services, a welcoming page and a listing of information providers, simplified billing, protocol conversion and other functions to ease the ability of users and information providers to communicate and electronic white pages.

Limited messaging and storage incidentally necessary to gateway functions would also be allowed, but not database storage. As we have emphasized in our pleadings before the Court, unlimited storage and messaging presents serious anti-competitive risks for electronic publishing as well as other information services.

At the same time, it is imperative that important safeguards are included so as to minimize the potential for anti-competitive behavior. The ANPA/U S West proposed order would require the regional companies to offer these services on a non-discriminatory and unbundled basis, and prohibits the regional companies from engaging in revenue sharing with information providers. These safeguards are essential to limit the "incentive and opportunity" for the regional companies to act anti-competitively with respect to information providers, including competing gateway operators. With the safeguards in place, the functionalities described in ANPA/U S West's proposed order have the potential for developing an infrastructure to spur the development of the electronic publishing market.

Mr. Chairman, ANPA opposed the Department of Justice's recommendation earlier this year to lift entirely the information services restriction because the regional companies still control local exchange facilities. With that control, and despite growth in the electronic publishing market, the regional companies retain the power to undermine competition. Regulatory safeguards are totally inadequate to prevent these potential abuses.

The underlying reason for the restriction on regional company provision of information services in the MFJ was their control of nearly 100 percent of the local telephone facilities within their service areas. The Court found that the regional companies bottleneck control gave them the same incentives and ability to discriminate against competing information services providers as the regional companies would have with respect to interexchange carriers.

In its September 10 decision, the Court determined that there has been no relevant change in the regional companies' bottleneck control over the local exchange facilities, and most importantly that they retain the same incentives

and ability to act anti-competitively against competing information service providers as they did three years ago.

Electronic publishers are dependent upon their local facilities for distribution of their electronic publishing services. A 1987 study by the Department of Commerce's NTIA documents that there is no alternative to two way real time interactive phone network for provision of most electronic publishing.

Let me be more specific about the ways in which the regional companies could discriminate against competing electronic publishers.

A phone company could give its own electronic publishing operations more favorable access to the network. Who controls the priorities for switching and access to trunk lines? Who controls whether a call gets direct or indirect routing? Who controls over which physical facilities the calls travel? Who controls the quality of the call? Who controls when an electronic publisher gets new or restored service? The answer to all of these questions is the regional company. For time sensitive electronic publishing services, issues such as how quickly a service obtains necessary network services, the quality of the underlying transport, and the length of time for dial up and responses to inquiries may be critical to its success or failure. The Court in its September 10 decision acknowledges the fragility and time sensitivity of information services.

The phone company also could discriminate by providing network and customer information to its electronic publishing operations, that is denied to competitors or provided later or on less favorable terms and conditions. For example, the phone companies are in a unique position as the owners of the local exchange networks to have far better access to information on network

traffic patterns, information on their competitors' use of the network and sensitive business information on their competitors' operations. Access to this information will give them a tremendous advantage over their competitors, especially in the development of new services and marketing efforts.

The regional companies also retain the same ability to cross-subsidize these new electronic publishing services with revenues from the monopoly service, a fact acknowledged by the Court in its September 10 decision. The Court noted the June 1986 report of the California Public Utilities Commission that found evidence of Pacific Bell's cross-subsidization of unregulated services with rate case revenues in the areas of personnel and property transfers. The California PacTel situation does not appear to be an isolated one. A National Association of Regulatory Utility Commissioners (NARUC) publication found that state regulators generally have similar concerns about regional company practices. The end result of cross-subsidization is higher rates for ratepayers and less diversity.

ANPA concerns regarding regional company entry into information services, and in particular, electronic publishing, are directly related to their virtual 100 percent bottleneck control of local phone lines. The fact that there are seven of them does not change the reality that each one of them has bottleneck control over nearly all local exchange services within its region.

As long as they each hold this position, the regional companies' role in the electronic publishing market should be one of a provider of the underlying transmission and related services. This is the role of the telephone company in France and it has worked. This division between content and conduit removes the serious threat of discrimination and cross-subsidization and provides the best guarantee of a diversity of information sources for the

American consumer. Judge Greene's September 10 decision is crafted to limit the regional companies' ability to behave anti-competitively, but at the same time would allow for development of an infrastructure to make it easier for consumers to access these services.

The electronic information market continues to grow albeit slowly. Newspapers represent but a small portion of the electronic publishing market. Many other companies both large and small are involved in publishing information over telephone lines.

The United States is a world leader in electronic publishing in terms of type of service and technological capability. (See Attachment 1) For example, the U.S. far exceeds other countries in the use of professional on line database services as measured by revenues. The U.S. also holds a leadership position for consumer-oriented electronic publishing services, and exports three times as much electronic information as is imported into the U.S. However, consumer market penetration for these services has been disappointingly low.

Our study and the previous experience of newspaper companies has convinced us that a single company whether or not it publishes newspapers cannot expect to develop this market on its own. Entry of the regional companies into the "gateway" arena may be the spark that is needed to develop this market in the United States. We look upon our common filing with U S West as an important step in our efforts to work with other information services providers, the regional companies and other entrepreneurs to spur the development of the electronic information services marketplace.

Judge Greene's decision would provide the regional companies with an opportunity to develop new business opportunities through the provision of gateways, but at the same time would preserve the important division between

content and conduit. ANPA believes it is possible to achieve the Court's stated goal of advancing "the encouragement of innovation to the end that the full benefits of a sophisticated telecommunications industry be made available to all segments of the American public in this Information Age."

We thank you for allowing us to present our views, and commend the subcommittee for its continued careful oversight of U.S. telecommunications policy.

Senator INOUE. Thank you very much.

Speaking in behalf of the president and CEO of CompuServe is the executive vice president, Mr. Maurice A. Cox.

Mr. Cox.

**STATEMENT OF MAURICE A. COX, EXECUTIVE VICE PRESIDENT,
INFORMATION SERVICES DIVISION, COMPUSE, INC.**

Mr. Cox. Thank you, Mr. Chairman and distinguished members of the subcommittee. My name is Maury Cox. I am Executive Vice President of CompuServe.

I am making this presentation in place of Charles McCall, the president and chief executive officer. As a result of the change in the schedule announced yesterday, Mr. McCall was unable to attend the hearing.

I appreciate very much the opportunity to participate in the panel concerning the MFJ's information services restriction. CompuServe has been an active participant in the triennial review proceeding before Judge Greene, examining whether the MFJ restrictions should be removed or modified.

We recognize the timeliness of the subcommittee's oversight hearing on this important matter.

At the outset, I wish to set the record straight on two key points. First, the claim by some that other countries lead the United States in the information services area is simply untrue. The American public has available an incredibly wide variety of useful, innovative, informative, and entertaining information services that are easily accessible, easy to use, and affordably priced. The services include simple electronic messaging, interactive conferencing, transaction services, such as home shopping, banking, and travel services, and retrieval of the latest news, financial, or sports information.

Subscriber bases are expanding as more and more Americans subscribe to these varied offerings by CompuServe and other independent providers.

Our prepared statement for the record more fully addresses this point.

The second key point is that the information services industry is subject to vigorous competition today. Indeed, CompuServe and

other providers welcome such strong competition. All we ask is that the competition take place in a fair environment.

As long as competitive information providers remain totally dependent upon the Bell operating companies for delivery of services to their customers, there is no way that fair competition can be preserved if the BOCs are allowed to provide information services.

Now, turning to the MFJ itself, CompuServe believes that Judge Greene's September 10 opinion represents sound public policy. His refusal to lift the information services restriction was based upon a detailed review of the factual record, which led him to the following conclusions.

First, in the 3 years since the MFJ was entered in 1984, neither technical nor market changes have reduced to any significant extent the monopoly control of the BOC's over the bottleneck, local exchange facilities upon which information service providers are dependent.

Second, the BOC's retain the incentive and ability to engage in discrimination and cross subsidization if they are allowed to provide information services.

Third, because of their almost total dependence on BOC facilities, information service providers are particularly susceptible to injury from any BOC anticompetitive practices.

And fourth, Mr. Chairman, the FCC regulations relied upon by the BOC's and the Department of Justice in seeking removal of the information services restriction would not be effective in preventing anticompetitive practices.

CompuServe agrees with Judge Greene's conclusions on these fundamental points. We also support Judge Greene's proposal to modify the restrictions to allow the BOC's to provide five narrowly defined "gateway" functions that would make user access to competitive information service providers even easier than it is at the present.

Judge Greene recognized that this proposal still poses significant competitive risks to independent information providers, such as CompuServe. In fact, he stated that the regional companies may be expected, based on past experience, to seek to use any authority granted to them to transmit information services as a springboard to furnishing information content.

Judge Greene allowed three rounds of comments from interested parties to submit their views concerning the definition of permissible information services. Of course, the BOCs, the Justice Department, the FCC, information service providers, consumers and others took advantage of this opportunity to comment. So Judge Greene now has a record before him presenting all sides of the information "gateway" issue.

In their filings, the BOC's argued for a fundamental rewriting of the information services restriction to allow the provision of all types of traditional information services, such as electronic mail, storage and retrieval, and electronic Yellow Pages.

CompuServe and others contend that Judge Greene should carefully delineate the five "gateway" functions that he defined in his September 10 opinion. Otherwise, the continued growth of a competitive information services market would be threatened by BOC entry.

As Judge Greene recognized, in any market in which the regional companies are in competition with independent information providers, their economic interest lies in manipulating the system toward use of their own services.

In sum, Mr. Chairman, CompuServe believes that the MFJ has created the conditions under which a very competitive information services market has been able to take hold and flourish in a marketplace that offers the American public a wide diversity of innovative, productivity-enhancing information services.

Therefore, there is no need at this time for legislation on this issue. Nevertheless, CompuServe appreciates this Subcommittee's interest in this important matter.

Thank you.

[The statement follows:]

STATEMENT OF CHARLES W. MCCALL, PRESIDENT AND CHIEF EXECUTIVE OFFICER,
COMPUSEIVE INC.

Mr. Chairman, Members of the Subcommittee, my name is Charles W. McCall, and I am President and Chief Executive Officer of CompuServe Incorporated. CompuServe, headquartered at 5000 Arlington Centre Boulevard, Columbus, Ohio 43220, is the country's largest providers of consumer and business information services. I appreciate the opportunity to testify before your Oversight Hearing on the Modified Final Judgment's ("MFJ") restriction of Bell Operating Company ("BOC") involvement in the provision of information services.

As described below, retention of the information service restriction is essential to prevent the BOCs from using their monopoly control over local exchange facilities to gain a competitive advantage over information service providers. At the same time, the modifications to the information services restriction proposed by the District Court in its September 10, 1987 *Opinion* will allow BOCs to provide functions that will facilitate user access to information services and further stimulate the burgeoning mass market for information services in America.

I. BACKGROUND: THE HISTORY AND SCOPE OF THE MFJ'S INFORMATION SERVICES
RESTRICTION

In 1982, after eight years of litigation, the Department of Justice ("DOJ") and AT&T settled a pending antitrust suit by entering a Consent Decree under which AT&T agreed to divest itself of the BOCs and to abide by provisions that restricted AT&T and BOC involvement in several lines of business. The decree was later modified by the U.S. District Court for the District of Columbia, and, as the Modified Final Judgment, codified the line-of-business restrictions. These restrictions were crafted to prevent the BOCs' involvement in specific lines of business where their monopoly control of local exchange facilities could be used to gain an unfair advantage over competitors. Among the activities proscribed to the BOCs was the provision of information services. The Court defined information services as:

the offering of a capability of generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications, except that such service does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.

Of significance to this panel, the MFJ also includes a provision governing the removal of the restrictions. Section VIII(C) of the MFJ provides that:

The restrictions imposed upon the separated BOCs by virtue of section II(D) shall be removed upon a showing by the petitioning BOC that there is no substantial possibility that it could use its monopoly power to impede competition in the market it seeks to enter.

The DOJ agreed to assist the Court in reviewing the need for continuing enforcement of the line-of-business restrictions by filing a report every three years following the adoption of the MFJ.

II. THE COURT'S SEPTEMBER 10 OPINION

The DOJ's first triennial report was filed in the Spring of 1987. In that report, the DOJ abandoned the positions it had taken only three years earlier, and stated that market and regulatory conditions had changed to such an extent that the information services restrictions, and most other line-of-business restrictions, were no longer necessary. The change in the DOJ position was premised largely on reliance upon several new regulatory initiatives currently being developed by the Federal Communications Commission ("FCC"), but as yet unimplemented.

In response to the DOJ recommendation, approximately 300 briefs, totalling about 6,000 pages, were filed with the Court. After reviewing this exhaustive record, the Court rejected most of the DOJ's recommendations. The Court made three central findings: (1) neither technical nor market changes have reduced to any significant extent the monopoly control of the BOCs over the bottleneck local exchange facilities upon which information providers depend; (2) BOCs retain the incentive—and have displayed a willingness—to engage in illegal discrimination and cross-subsidization in order to obtain an advantage over competitors; and (3) the prospective FCC regulations have yet to be implemented or tested, and are, in any event, wholly inadequate to prevent BOC anticompetitive conduct.

These findings compelled the Court to leave intact the MFJ's information services restriction. The Court did, however, find that the BOCs should be allowed to provide certain "gateway functions" that would make user access to the services of competitive information service providers even easier than it is at present.

In proposing to amend the information services restriction to allow such functions, the Court found that even this limited level of BOC involvement in information-related functions posed a significant risk of anticompetitive conduct. The Court found that the BOCs "may be expected, based on past experience, to seek to use any authority granted to them to transmit information services as a springboard to the furnishing of information content," and found it necessary to ensure that "the authority of the Regional Companies is carefully limited. . . ." The Court therefore sought comment on the appropriate way to delineate permissible "gateway services" that would fall short of information content. It defined five specific categories of gateway service: (1) data transmission; (2) address translation; (3) protocol conversion; (4) billing management; and (5) introductory information content. The Court also proposed to allow BOCs to provide "white pages" directory services. Noting the absence of a complete record concerning the various components of the gateway, however, the Court solicited comments "detailing the necessary ingredients with greater particularity." To date over 100 briefs, totalling approximately 1,500 pages, have been filed.

The BOCs have all proposed extraordinarily broad definitions of "gateway services" that would allow them to provide services not clearly prohibited by the information services restriction, including such information services as database information storage and retrieval, electronic mail and other electronic messaging services, electronic directory services, credit verification, and other services that are currently being offered to the public on a competitive basis.

While six of the BOCs propose that they be unrestricted in providing such services directly to consumers, US West, joined by the American Newspaper Publishers Association ("ANPA") proposes that BOCs be allowed to provide these services only to the extent necessary to achieve "transparency" between users and information providers. The US West/ANPA proposal would also purportedly limit BOCs to provision of information services on a "wholesale" basis to information providers, and would disallow direct sales to consumers. As CompuServe has shown in its comments to the Court, and as discussed below, these attempts by the BOCs to provide information services beyond those narrowly-circumscribed gateway functions that would facilitate greater user access, threaten the continued robust growth of a competitive information services market.

III. THE DISTRICT COURT'S APPROACH IS SOUND AND SHOULD BE RETAINED

While CompuServe acknowledges the Court's capable analysis of a large and complex record, we believe that the Court may not have fully appreciated the large number and wide variety of competitive information services currently available to the American public. Nevertheless, we find the Court's general approach sound. It strikes a balance between the desire to make consumer access to information services greater than it already is, and the need to prevent BOC abuse of their monopoly status. In order to evaluate this balance, it is important to appreciate the role the MFJ has played in the development of the current information services market.

A. The Information Services Restriction Has Created An Environment In Which A Burgeoning Mass Market For Information Services Has Developed

The MFJ's information services restriction was imposed to foster the growth of a competitive industry shaped by technological innovation and consumer demand. There is no question that the MFJ's goal is being realized: recent years have witnessed a dramatic proliferation of innovative information services and a consistent growth in the number of consumer and business users.

The type of information service most familiar to consumers is "electronic publishing," which includes the display of videotex on a terminal screen. The videotex displayed can represent information retrieved from databases, or can relay messages between users in an electronic mail or electronic conferencing system. Other information services that are used predominantly for business applications include high-volume, high-speed data transport, which is provided on a stand-alone basis, or as part of other discrete services, such as point-of-sale credit authorizations. As described more fully below, many information service providers, including CompuServe, also offer gateway service, connecting users to a multiplicity of independent information providers. These gateways allow consumers to move from one independent service to another easily, without the need to log off and log on, and without requiring presubscription.

1. The diversity of information services available from CompuServe

While CompuServe is the country's largest provider of information services, it has become in many ways representative of the many service providers that comprise the information and enhanced services industries. CompuServe currently provides consumer information services to approximately 400,000 active residential and educational and non-profit institutional subscribers. The growth rate in CompuServe subscribership is accelerating and the service now attracts new subscribers at a rate in excess of 10,000 per month.

CompuServe has over 1,100 consumer services and databases available to its customers. To provide these services, CompuServe maintains North America's largest electronic general information base. CompuServe's consumer information services run the gamut from business and home management to education and entertainment. Consumer services allow subscribers to bank at home, book airplane flights and purchase everything from stocks and bonds to specialty food items. The consumer may access stock market information, investment and return analyses, portfolio management services, special interest forums and even a checkbook balancing service. CompuServe also offers a host of instructional and reference services, including foreign language instruction, medical databases, computer-user forums, an online encyclopedia and news services. Entertainment services include an array of interactive and multi-user video games, online bulletin boards, movie, record, and concert reviews and listings, and forums on recreational topics. Subscriber interest is equally diverse: the top ten services in popularity include CB Simulator,¹ a stock quotation service, a news service and computer games.

Approximately 1,300 large and small corporations rely on CompuServe's network and business information services, and account for over 50 percent of all revenues. CompuServe's business services include specialized databases, electronic mail services, data transport, database management, application software and credit card authorization services. CompuServe's clients include the top 25 Wall Street investment banking firms and major financial service organizations, including the nation's largest processor of debit-card transactions at the point of sale. CompuServe links purchasers and suppliers and marketing and order inventory departments, supplies and network for the room reservation system of a major motel chain, makes census data available to research departments of major firms and coordinates the timely, accurate flow of information within some of the nation's largest enterprises. In addition, our country's largest supplier of bibliographic information to libraries maintains and makes available through CompuServe a database of more than 14 million books and periodicals.

CompuServe's subscribers are able to access its information services with a local phone call in more than 600 cities in the United States. These information services can also be accessed from 79 countries.

¹ CB Simulator is an online interactive service that allows subscribers to conduct non-voice communications between individuals and groups of individuals using computer terminal devices.

2. The diversity of services available throughout the American information services industry and the competitiveness of the industry

The incredible variety of services and explosive growth in demand is not unique to CompuServe. The claims by the Regional Companies and others that other countries lead the United States in the information services area are simply untrue. The American public has available the widest variety of useful, informative, innovative, and entertaining information services in the world, and these services are easily accessible, easy-to-use, and affordably priced. There are no services available in other countries that are not available in this country.

Moreover, the marketplace is robustly competitive, with major companies such as General Electric, IBM, Sears, Dow Jones, and others competing in the marketplace. CompuServe does not shy away from such vigorous competition. Indeed, we welcome it. All CompuServe asks is that the competition be in a fair environment. As long as CompuServe and other information service providers are totally dependent upon the bottleneck local facilities controlled by the Regional Companies, there is no way that the Regional Companies can be allowed to provide information services and, at the same time, compete on a fair basis.

The Commerce Department estimates that, as of 1986, "[t]he United States has approximately 900 database producers and 300 on-line vendors." For 1987, the revenues for the information services industry will exceed \$20 billion—and this number is growing rapidly.

Public electronic mail service is an example of a particular information service where growth has been dramatic—and where competition is vigorous. CompuServe, AT&T, Computer Corporation of America, Dialcom, MCI, Telenet, and Western Union, among others, offer electronic mail service to the public. Use of the services has grown from less than 170 million messages sent in 1984, to over 400 million in 1987, and is projected to reach over 2 billion in 1991.

The large number of users of information services is demonstrated by the fact that there are approximately 15 million modem-equipped personal computers in this country, of which 4-5 million are in homes. A modem-equipped computer indicates usage of one or more remote databases of information services. And, it is important to understand that for every modem-equipped computer, there are frequently several users.

Competitive companies, including CompuServe, Computer Services Corporation, General Electric Information Services Company, Telenet Communications Corporation, and Tymnet-McDonnell Network Systems Company also provide the "gateway" services that the Court is now allowing the BOCs to perform. The gateway features currently offered by information providers allow their subscribers to access the services of independent, third party service providers. For instance, CompuServe Subscribers can access Easys Sabre and Official Airline Guide Electronic Edition airline reservation systems, Travelshopper travel service, and Einstein and IQUEST database retrieval services. Moreover, Einstein and IQUEST are themselves gateways to other services. For example, IQUEST provides access to over 800 databases, and upon receiving a single information request, it can perform a "universal search" of all of 800 databases. CompuServe provides billing services to the independent information providers, presenting the consumer with a single bill for all services used.

CompuServe's gateway services are an example of a rapidly-growing trend among information providers. A recent study by Cuadra Associates, an independent research firm, found that, "[b]y the end of 1986, there were a total of 3,369 publicly-available databases. Of these, one third were already available through gateways, and the number is growing."

Furthermore, the provision of information services is one of the few markets in which the United States has a substantial trade surplus—America is by far the largest exporter of computerized information in the world. Indeed, the Congressional Office of Technology Assessment estimates that in 1984, the last year for which data are available, the United States ran a surplus of over \$2.5 billion in information services trade.

CompuServe is a good example of the United States' leadership—and the trade benefits that result from this leadership—in the information services area. While the Regional Companies frequently cite Japan as one of the countries that is ahead of America in making available information services to the public, CompuServe provided the technology and the information services upon which Japan's fastest-growing information service is based!

B. Absent The Information Services Restriction, BOCs Would Have The Ability And Incentive To Engage In Anticompetitive Conduct Against Competing Information Providers

1. The information services industry is uniquely susceptible to BOC anticompetitive conduct

In the September 10 Opinion, the Court found, and the record clearly shows, that BOCs retain monopoly control of the bottleneck local exchange facilities that the information service providers must use in order to deliver their services to consumers. The Court found no evidence to support claims that information providers were able to use alternative facilities or services to deliver their product to users' homes or offices, and concluded that "information service providers remain as dependent upon [BOC] facilities, and those who control them, as they did in 1984" Indeed, Judge Greene concluded "[t]here has been no change whatever in this respect since 1984, and no demonstration that now, unlike then, there is no substantial possibility that the Regional Companies could not, and indeed would not, use their monopoly power to impede competition in the information services market." The Court noted that a recent report by the National Telecommunications and Information Administration ("NTIA") and the 1987 Huber Report to the DOJ supported this conclusion.

Indeed, one of the commentators in the proceeding, using data contained in the Huber Report, calculated that BOCs enjoy a 99 percent share of the exchange service market and a 96 percent share of the exchange access market. This calculation is consistent with CompuServe's experience. In operating areas served by the BOCs, all local circuits used by CompuServe to provide information services were obtained from BOCs. In other areas, CompuServe obtained all its local circuits from the franchised independent telephone companies in those areas. CompuServe is, therefore, totally dependent on BOC facilities when it operates in BOC service areas. As Judge Greene put it, "the Regional Companies continue to possess bottleneck control over the local exchange facilities, and these are the facilities upon which competitive information providers, like the Regional Companies' competitors in the interexchange and the manufacturing markets, depend."

The record in the proceeding also shows that this monopoly control of crucial local exchange facilities empowers the BOCs to use anticompetitive activities to gain an advantage in the market. The Court cited the Huber Report's finding that BOCs would have extensive opportunities to cross-subsidize any information services that they were allowed to provide. The Huber Report concluded, for example, that: (1) 70 percent of electronic mail costs are potentially shiftable; (2) 44-78 percent of credit card authorization services are potentially shiftable; and (3) 70-90 percent of alarm service costs are "highly susceptible to misallocation."

The record further shows that the nature of information services renders information service providers uniquely susceptible to BOC discrimination. The Court noted that information services are inherently time sensitive and are adversely affected by even slight degradations in transmission quality and speed. It found that BOCs could gain a considerable advantage over information providers by manipulating the speed or quality of access lines and private lines; by discriminating in pricing lines used by information service providers; or by manipulating their networks to take advantage of planned, but not publicly disclosed, technical changes.

2. The record shows that BOCs have used their monopoly power to gain competitive advantages over information service providers

The Court found that, despite the line-of-business restrictions that were expressly designed to minimize the BOCs' opportunities to engage in such anticompetitive behavior, "these companies appear nevertheless to have managed to discriminate and cross-subsidize." Indeed, the record contains many documented accounts of information service providers, including CompuServe, that have been victims of BOC discriminatory pricing, delays in repairing service disruptions or in installing new lines, or refusals to provide necessary network and listing information. The record also refers to findings or regulatory bodies such as the NARAU, the California Public Service Commission and New York State administrative law judges that found specific instances of BOC illegal cross-subsidization, discrimination, and failures to maintain adequate data.

As the BOCs have demonstrated the ability and willingness to use their monopoly power to anticompetitive effect, the Court found that BOCs would have the incentive to use this power against information service providers if they were ever to compete directly against them. The Court found that, "in any market where the [BOCs] are in competition with independent information service providers, their economic interest lies in manipulating the system toward use of their own services,

rather than in encouraging maximum use of the network by their information service competitors."

3. The information services restriction is an essential check against abuse of BOC monopoly power

The policy rationale behind the Court's finding is unassailable. If the BOCs are allowed to compete directly against independent information service providers, the record shows that they will have the ability and opportunity to discriminate and cross-subsidize to gain an unfair advantage over their competitors. In doing so, the BOCs will have every incentive to drive information providers out of the market in order to maximize their market share. On the other hand, the MFJ restriction prevents BOCs from profiting from such services, and restricts their information services involvement to the provision of telecommunications transport and related services that will facilitate user access to information services provided by independent companies. The BOCs' economic interests therefore lie in increasing the quality and availability of their transport services to accommodate the greatest number of information service providers possible.

Accordingly, under the MFJ, both BOCs and information service providers stand to prohibit as increasing numbers of information service providers make more services available to a growing mass market of American consumers. Absent the information services restriction, the BOCs stand to prohibit by expanding their monopoly control over local exchange facilities into control over information services.

a. The BOCs' proposed gateway services would permit anticompetitive conduct

Because the BOCs retain the ability and incentive to engage in anticompetitive conduct against information providers, CompuServe strongly opposes the positions taken by the BOCs in their attempts to define permissible gateway services. Most BOCs seek a fundamental redefinition of the information services restriction to allow them to provide a wide range of currently proscribed information services. These BOCs seek the ability to provide electronic mail and messaging services, database services, credit card authorization services and electronic yellow pages, in direct competition with existing information service providers. The MFJ's restriction on such direct competition must be retained.

b. The U.S. West/ANPA proposal is similar flawed

The same rationale compels rejection of the U.S. West/ANPA proposal. The fact that this proposal purports to restrict BOCs to "wholesale" provision of information services does not eliminate BOC incentives to engage in anticompetitive practices. BOC provision of storage and retrieval services to information providers would lead to differing levels of involvement with different providers. For instance, information service providers such as CompuServe, which provide credit verification services and electronic mail and messaging using their own networks, would choose not to purchase such services from the BOCs. A competitor that did not have adequate facilities, on the other hand, could purchase "wholesale" messaging and credit authorization services from the BOCs. Because the BOCs' revenues from their wholesale services would grow in direct proportion to the market share of the aspiring competitor, the BOCs would have every incentive to engage in the various anticompetitive practices delineated by the Court in order to foster the growth of their wholesale customer. Thus, even though the BOCs may not be competing against CompuServe directly on a "retail" level, they nevertheless would have a financial interest in the success of CompuServe's direct competitor. Thus, such "wholesale" involvement in information services would raise exactly the same anticompetitive concerns as direct competition by the BOCs.

Moreover, it would be impossible for the Court or anyone else to distinguish between "wholesale" and "retail" trade in information services. For instance, if a large corporation wanted to establish an electronic mail network for internal use, it would be considered a retail user, and would not be able to purchase the service from a BOC. However, if the corporation obtained additional capacity and "resold" it, say, to an affiliate, it might be classified as an information service provider, and would be free as a "wholesaler" to deal directly with the BOC.

The best evidence of the flawed nature of the U S West/ANPA proposal is found in their own statements concerning the proposal. The comments of U S West and ANPA differ considerably on the extent to which their proposal would allow the BOCs to provide storage and messaging services to independent information providers. While U S West apparently seeks Court approval to provide unrestricted storage and messaging capabilities to information providers, ANPA would not allow provision of such services for direct resale to consumers. Similarly, U S West and ANPA appear to differ on the type of information that BOCs would be permitted to

include in their "white pages" services. Clearly, the U S West/ANPA proposal is seriously flawed if its authors cannot agree on a proper interpretation of its provisions. In fact, a majority of the commentators who filed comments on the U S West/ANPA proposal, including five of the BOCs, attacked the proposal as vague and unenforceable.

c. BOC proposals to provide additional services must be rejected.

In addition to the proposal described above, several BOCs seek the ability to search multiple information service databases for users, or to store information service provider data, for access by a user at a later time. These proposed services would interpose the BOCs between the information service providers and their clients, effectively transforming the BOCs into resellers of information service provider data. Such BOC involvement in information services would reduce both consumer and information provider control over information service transactions, and would severely restrain providers' ability to offer innovative service and pricing options. Moreover, if BOCs could perform searches for users, they would have editorial control over the search, and would act as the arbiter of how the search is phrased and what databases would be accessed. This extraordinary control would transform BOCs from gateways to gatekeepers, able to select which information providers are accessed.

Several BOCs also seeks to compile and sell sensitive consumer information, such as the type of service individual consumers use most frequently, the times of day they access information services, the amount of money they spend per month on information services, and the types of terminal equipment they use. In providing gateway services, such as billing and connecting consumers to information service providers, the BOCs will gain access to this sensitive customers sales data, which is otherwise closely protected by information service providers. If the BOCs were allowed to compile this data in "master customer lists" they would control an invaluable marketing tool that would yield very detailed demographic data concerning the consumer base for different information services. If the BOCs were to compete directly against information providers, or to procure an indirect financial interest in an independent provider, such data would give them a clear competitive advantage.

Furthermore, such data in the hands of the BOCs raises considerable privacy concerns. For example, the BOCs would have possession of, and control over, sensitive information of users such as financial information and usage habits.

4. FCC Regulations do not offer adequate protections against BOC anticompetitive conduct.

Finally, it is important to note that the DOJ premised its recommendations to remove the information services restriction largely on its assumption that regulations currently being devised by the FCC, including cost accounting rules and "open network architecture" ("ONA") interconnection standards, would provide adequate protection against BOC anticompetitive conduct. The Court rejected these arguments, finding that the FCC's regulations are not fully developed, much less implemented, and that their effectiveness in preventing BOC cross-subsidization and discrimination is wholly speculative at this time.

The record clearly supports this skepticism. The General Accounting Office ("GAO") and several members of Congress have expressed concern that the FCC may lack the resources to enforce its cost accounting rules, and may be unable to prevent cross-subsidization. The GAO recently issued a report concluding that: "The level of oversight FCC is prepared to provide will not, in GAO's opinion, provide telephone ratepayers or competitors positive assurance that FCC cost allocation rules and procedures are properly controlling cross-subsidy." Furthermore, the GAO found that the FCC could not circumvent this problem by relying on private accounting firms, stating that: "[T]he difficulty in allocating costs of services sharing common facilities and personnel, particularly switching equipment, along with FCC's mandate to determine that regulated telephone rates are 'just and reasonable,' require ultimately that FCC exercise its own judgment that the telephone company costs are properly allocated."

Similarly, the FCC's ONA plan cannot protect competitors against discriminatory interconnection arrangements. The BOCs' proposed ONA plans have not yet been filed with the Commission. When they are filed in February 1988, they will then be subject to public comment by interested parties. When, and to what extent, they will be implemented, cannot be determined at this time. Moreover, as the Court noted, "[t]he Department of Justice itself concedes that it is 'unclear just what the impact of ONA on the potential for discrimination will be and how those effects will vary from market to market.'"

The court succinctly described the shortcomings of the FCC's regulations when it stated that:

In sum, the regulations relied upon by the Regional Companies and the Department of Justice to curb discrimination by the Regional Companies against their putative competitors in the markets they seek to enter are entirely inadequate: they either predate the decree and were found at the trial to be ineffective; they are not sufficiently comprehensive; they contain large loopholes; or they are a long way from being promulgated, let alone being implemented.

Reliance on FCC regulations to replace the information services restriction is therefore obviously misplaced. When the DOJ's next triennial review is undertaken in 1990, the FCC's cost accounting and ONA rules presumably will be in effect. At that time, all interested parties will be in a better position to evaluate their effectiveness in preventing BOC anticompetitive conduct, in conjunction with the assessment at that time of the BOC's control of the bottleneck local facilities.

IV. RELATED RECENT DEVELOPMENTS: THE NTIA PETITION FOR FCC ACTION

The National Telecommunications and Information Administration recently filed with the FCC a petition for a declaratory ruling that asks the FCC to find that BOC provision of information services would serve the public interest. The NTIA contends that such a determination by the FCC would take legal precedence over the Consent Decree signed by the DOJ and AT&T, with the consent of the BOCs, and approved by the Court, and that this action would effectively supersede the MFJ. The FCC has solicited public comment on the petition, with initial comments due December 30.

Of course, the NTIA's legal analysis in this matter is flawed. In addition, as demonstrated above, its factual appraisal of the current variety and availability of information services in this country is wrong, and it completely fails to address the anti-trust concerns that prompted the creation of the MFJ. The shortcomings of the NTIA petition also include a mischaracterization of the Congressional intent underlying several provisions of the Communications Act of 1934. While an analysis of the NTIA pleading is beyond the scope of this testimony, CompuServe will provide such analysis in the comments it will file with the FCC. At that time, of course, CompuServe would be pleased to share its analysis with the members of the Subcommittee or their staff.

V. CONCLUSION: THE INFORMATION SERVICES RESTRICTION, AS MODIFIED BY THE COURT'S SEPTEMBER 10 OPINION, WILL FACILITATE CONSUMER ACCESS TO INFORMATION SERVICES WHILE PROTECTING AGAINST BOC ABUSE OF MONOPOLY POWER

The MFJ's information services restriction, if modified as the Court has proposed in its September 10 *Opinion*, will provide a reasonable balance between the desire to facilitate user access to information services and the need to minimize the BOCs' abilities to use their monopoly control over essential local exchange facilities to anticompetitive effect. The history of BOC conduct as recounted in the MFJ and the evidence submitted by disinterested regulatory bodies, as well as information providers, clearly show that BOCs will engage in cross-subsidization and discrimination if they stand to profit from such anticompetitive behavior. It is therefore essential that the BOCs continue to be prevented from competing directly against information service providers by selling information services to users, and from competing indirectly by selling information services on a "wholesale" basis to selected providers.

The record of the Court's proceeding shows that neither technological developments, market force, nor administrative regulations have today resulted in a lessening of the BOCs' ability to engage in anticompetitive behavior. The MFJ, by tying BOC profits to the provision of transport services that will support independent information service providers, aligns the financial interests of BOCs and information service providers. In so doing, it reduces the BOCs' incentives to discriminate and cross-subsidize, and provides an incentive for BOCs to configure their networks to serve as many independent information service providers as possible. The MFJ thereby contributes to the continuing development of a robustly competitive, innovative and diversified mass market for information services.

Because the MFJ remains effective in performing this function, CompuServe believes that direct Congressional action in this area is not required at this time. CompuServe is, however, encouraged by the level of interest displayed by the Subcommittee, and appreciates this opportunity to express its views.

Senator INOUE. Thank you very much.

As some of you know, a vote is now pending in the Senate, but we would like to continue a little further before we stand in recess.

Our next witness is Mr. Kimmelman, of the Consumer Federation of America.

**STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR,
CONSUMER FEDERATION OF AMERICA**

Mr. KIMMELMAN. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, on behalf of the Consumer Federation, I appreciate this opportunity to present our views on issues related to the modified final judgment and particularly the information services restriction.

As you know, our organization opposed lifting the restrictions placed on the Bell companies, including information services, and I would like to give you in very short form a description of why we took that position, particularly related to information services.

I think it is important to see the MFJ in the context of everything that has been going on for telephone users in this country for the last few years.

We are just now emerging from what has been the most turbulent period in telephone history. The confusion that consumers faced as a result of the divestiture of AT&T was massive. It was a major change in how the American public does its telephone business, how the American people use the telephone.

Immediately following that, we were deluged by rate increase requests from the regional Bell companies, requests totaling over \$11 billion in the two years immediately following the breakup of AT&T. Simultaneously, the American public was hit with regulatory decisions that have done nothing short of hurting consumers.

We have a proposal from the Federal Communications Commission that transforms about \$2.6 billion of long-distance costs into local rate increases. I believe that without the leadership of Senator Packwood, that would have been much worse and consumers would have been hit much harder.

In addition, the same regulators have eliminated what has been the best cross-subsidy deterrent mechanism—separate subsidiaries—and replaced it with a complicated cost allocation scheme, which has been described by the General Accounting Office as something which does nothing but create problems for preventing the over-pricing of basic telephone service for the American public.

At the same time, in this confusion the regional Bell companies have somehow eluded careful regulatory scrutiny, and they are earning 3 percentage points greater profits than either other utilities in this country in the last 3 years or the most competitive large corporations in this country.

So we believe Judge Greene's ruling, which insures stability and limits the likelihood of pressure for further local rate hikes is a welcome relief to consumers, and it makes sure that we will not experience another revolutionary restructuring of our telephone system just four years after the last, at least not from the courts.

What Judge Greene did in the information services area is an appropriate balance from our perspective. The judge has opened the

door for consumers to the availability of new services without threatening the addition of fancified computerized network equipment to our Nation's telephone infrastructure, equipment that may drive up the price of basic phone service.

Now, consumers want the opportunity to have new services. But they also want to keep basic, plain, old telephone service cheap.

Much has been made of the wonders of the information age services and how only if we let the Bell companies into these markets will consumers' needs be met in this area.

Mr. Chairman, our organization is skeptical about this approach because we are not convinced that there is any unmet consumer demand for these services. All the recent surveys that we have seen show that consumers are not really interested in fancy, new information services, at least not yet.

And, furthermore, we are fearful that opening this market to the Bell companies could lead to higher local rates for consumers around the country. So, in conclusion, Mr. Chairman, we support Judge Greene's ruling and believe that the stability and consumer protections provided by the judge's decision will help preserve the goal of affordable phone service for all Americans, while carefully opening the door to new communications services for consumers.

Thank you.

[The statement follows:]

STATEMENT OF GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

After the shock resulting from the break-up of American Telephone and Telegraph (AT&T), unprecedented post-divestiture local rate increases and anti-consumer regulatory decisions, U.S. District Court Judge Harold Greene's recent decision to maintain the current structure of our telephone system is a welcome stabilizing development for consumers. Judge Greene's ruling¹ reduces the likelihood of further local rate hikes by limiting local phone company ability to overprice local rates and underprice competitive services. While the Consumer Federation of America (CFA) believes the Congress must ultimately update the 1934 Communications Act to protect consumers' needs in the changing world of telecommunications, we see no reason to upset the consumer protections that serve as the basis for Judge Greene's ruling.

Inevitable consumer confusion following the AT&T breakup became outright fear as the Regional Bell Operating Companies (RBOCs) asked for over \$11 billion in rate increases between 1984 and 1986.² Although state regulators granted only about half the RBOCs' revenue requests,³ the Federal Communications Commission (FCC) has transformed \$2.6 billion of long distance charges into local rate increases (called "subscriber line charges").⁴ It should come as no surprise that in the face of such rate increases and a new industry structure, consumers are skeptical about the need to restructure the industry again, only three years after the shock of divestiture. CFA therefore opposed the Department of Justice and RBOCs' recent efforts to eliminate the restrictions place on the RBOCs in the *Modification of Final Judgment* (MFJ) and supports Judge Green's decision to leave "well enough" alone.

Since the RBOCs' local telephone operation is still a monopoly, these companies have an incentive to take revenue from local rates—where consumers have no choice of alternative service providers—and subsidize more competitive services. Even under the MFJ, where the RBOCs have been excluded from manufacturing, information services and the inter-LATA long distance markets, the Bell Companies have eluded regulatory scrutiny.

¹ *United States v. Western Electric Company, Inc.*, Civil Action No. 82-0192 HHG, Order and Opinion of September 10, 1987.

² Gene Kimmelman and Mark Cooper, *Divestiture: Two Years Later*, CFA, December 1986.

³ *Id.*

⁴ FCC Report No. DC-890, reporting action in CC Dockets 78-72 and 80-286, Mimeo No. 2837 (April 16, 1987).

For the last three years the RBOCs, despite operating in predominantly monopoly markets, have been earning profits 2-3 percentage points higher than our nation's largest, most competitive firms (see Table 1). With the FCC's recent decision subsidiaries—in form of complicated cost allocation procedures,⁵ and the loosening of regulatory procedures in many states, ratepayers have more to lose than ever before from RBOC expansion into new markets. As the General Accounting Office recently pointed out, this new regulatory regime "will not, * * * provide telephone ratepayers or competitors positive assurance that the FCC cost allocations rules and procedures are properly controlling cross-subsidy."⁶ without the MFJ restrictions, the RBOCs would have greater incentives and opportunities to divert revenue from basic phone service to finance competitive ventures, endangering the affordability of phone service for many families.

EXHIBIT 2.—RETURN ON EQUITY: TELEPHONE COMPANIES COMPARED TO TOP 1000 CORPORATIONS

	1984	1985	1986	1987
Ameritech.....	14.1	14.5	15.0	14.9
Bell Atlantic.....	13.1	13.8	14.1	14.4
Bell South.....	13.4	14.2	14.4	13.8
NYNEX.....	12.9	13.3	13.9	13.7
PACTEL.....	12.8	12.8	14.1	12.3
SW Bell.....	12.9	13.6	13.4	12.8
US West.....	13.3	13.3	12.7	12.9
Top 1,000 Corps.....	13.2	11.4	10.4	10.9

Sources: Business Week, "Scoreboard Special, 1985," "The Top 1000, 1986," "Corporate Scoreboard," (March 16, 1986; November 16, 1987). For 1986 and 1987, only the top 900 corporations are included.

Despite the inability of current regulation to prevent cross-subsidization, some interest groups have recommended that Judge Greene allow the RBOCs to provide "gateway" information services ranging from electronic mail to voice/data forwarding, storage and retrieval. Disregarding the dangers to universal service that a fancified-computerized network pose, these groups argue that RBOC provision of information services would bring the information age into all American homes. Unfortunately, this proposal underestimates the danger of cross-subsidy (described above), and overestimates consumer interest in information services.

All empirical studies of consumer demand indicate that even though most individuals consider the telephone a necessity for basic communications, very few use or are interested in using the phone for fancier computer/information service functions. A recent study of 1,000 business and 2,000 residential telephone subscribers in Ohio conducted by National Regulatory Research Institute indicates that about 84 percent of residential customers view the phone as a necessity, yet very few use advanced telecommunications technology (only about 2 percent report owning a modem) and over 60 percent could not describe a new phone service they would need in the next five years.⁷ Similarly, 84 percent of the business respondents said they use their telephone lines exclusively for voice transmission.⁸ Similar research shows that about 80 percent of individuals surveyed do not own a computer—an item essential to accessing most information services—and even fewer low income and elderly individuals have access to or interest in "information age" services.⁹ While we hope that the information service industry will develop new services that consumers want and need, demand for such services is currently inadequate to justify the risks of cross-subsidy involved in RBOC provision of information services.

CFA has therefore asked Judge Greene to allow the RBOCs to provide no more than a limited gateway that would offer an easy link between consumers and information services providers. We believe this would increase consumer choice and provide the benefits of new technology, without endangering the affordable, universal distribution of basic telephone service.

⁵ In the matter of Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), CC Docket No. 85-229, adopted May 15, 1986.

⁶ U.S. General Accounting Office, *Telephone Communications, Controlling Cross-Subsidy Between Regulated and Competitive Services*, GAO-RCED-88-34 at 3.

⁷ *BOC Week*, November 16, 1987 at 6-7.

⁸ *Id.*

⁹ Dr. Mark Cooper, *The Telecommunications Needs of Older, Low Income and General Consumers in the Post-Divestiture Era*, AAARP AND CFA, October 1987 at 39-46.

Unless the fundamental economics of the telecommunications market change and consumer demand for information services grows, it makes no sense to upset the stability that Judge Greene's ruling provides. Consumers are not prepared to jeopardize affordable basic phone service just for the possibility of receiving unknown, exotic computer services that they may not want or need. CFA believes Judge Greene's ruling will help protect consumers from unnecessary rate increases while increasing the availability of new computer services for individuals who want them.

Senator INOUE. I thank you very much.

The subcommittee will stand in recess for ten minutes.

[Brief recess.]

Senator INOUE. The subcommittee will come to order.

Our final witness this morning is Michael S. Field, vice president, Customer Information Systems, the Dun & Bradstreet Corp.
Mr. Field.

STATEMENT OF MICHAEL S. FIELD, VICE PRESIDENT, CUSTOMER INFORMATION SYSTEMS, THE DUN AND BRADSTREET CORPORATION

Mr. FIELD. My name is Michael Field, and I am vice president of the Dun & Bradstreet Corp., responsible for corporate-wide planning and oversight in the area of information systems and communications.

I very much appreciate this opportunity to share with you my observations and suggestions on public policy and the electronic information services marketplace.

Dun & Bradstreet is a major worldwide supplier of information, primarily to business, and is made up of over 30 major business units. These businesses serve customers who expect to have information products delivered on-line—that is, through highly interactive forms of “videotex” and “audiotex” services.

One of my major responsibilities is the overall supervision of Dun and Bradstreet's worldwide data network, which we call “DunsNet.” Its U.S. developed hardware and software is now in use in ten other countries.

This network provides the means by which Dun and Bradstreet customers can be linked to the wide range of Dun and Bradstreet's information services.

My work requires me to travel worldwide to evaluate, plan and arrange for the information distribution systems needed to serve our customers.

Based on this experience, let me summarize four key points which will be treated in much greater depth in a memorandum which we will submit at a later date to the Committee.

Firstly, I can assure you that we, as a Nation, have been and are today the world leader in telecommunications and information services—information hardware, software, processing, content, electronic publishing and information distribution systems. Because of the initiative and enterprise of hundreds of other companies building on the basic foundation of this voice telephone network, the United States has the world's largest set of data networks, perhaps larger than those of all the rest of the world put together.

Secondly, United States' leadership has been preeminent because it is based on a competitive marketplace response to customer needs.

We shall maintain that leadership to the extent that the United States continues to provide a robust and fully competitive marketplace for information systems, products, and services.

Thirdly, the promotion and preservation of a vigorously competitive marketplace for information services was a major objective of the AT&T consent decree. It is important to keep in mind that this case was the fourth major antitrust dispute involving the U.S. government against the Bell Companies in the last seventy five years. In fact, the MFJ extended and modified the consent decree from the previous case. Two principal lessons can be drawn from this history. First, control over the monopoly of local telephone service in conjunction with rate of return regulation inevitably gives rise to anticompetitive behavior in the marketplace against other providers of telecommunications products and services which depend to some degree on local telephone monopoly service. This is harmful to consumers, to the further development of the telecommunications industry, and to the U.S. economy. Second, regulation has not been able to check such anticompetitive behavior, particularly at the boundaries of emerging technology and markets adjacent to telecommunications.

In the most recent case, divestiture of the local operating companies and the imposition of line-of-business restrictions on the newly created Regional Bell Operating Companies were the twin elements of the antitrust remedy to promote robust competitive markets for telecommunications equipment and services and to prevent anticompetitive behavior by the RBOC's.

The consent decree was finalized just over 3 years ago, and affirmed by the U.S. Supreme Court.

Fourthly, the Minitel videotex system in France is frequently mentioned in the current discussion as evidence that the United States is falling behind in information services. Dun and Bradstreet participates in this system as another way for our customers in France to reach our information data bases. It is a successful service, but one that we have found to have limitations.

In any event, Judge Greene's opinion of September 10 permits the Bell Operating Co. to provide the transmission infrastructure which will permit an improved service to take root and flourish here if there is sufficient marketplace demand.

We believe that the above analysis points the way toward the elements of a public policy in dealing with this complicated problem.

I respectfully suggest for your consideration, Mr. Chairman, the most important of these elements, as follows.

First, continue to rely on a robust competitive marketplace to develop further our electronic information systems, services and products. Limiting the participation of those who still have monopoly control of local telephone service, a service essential for information providers, is necessary in order to preserve the competitive process and prevent the extension of the telephone monopoly into content services.

Second, recognize and support Judge Greene's conclusions that those who exercise monopoly control of essential transmission facilities on a noncompetitive basis have the opportunity and the natural incentive to use their economic power in a way to unfairly

compete with those, such as information providers, who have to rely on monopoly provided transmission facilities to reach their customers.

Over time, if such transmission supplies are permitted to become information providers as well, it is probable they will gradually come to dominate both parts of the business.

As history has shown, workable and in-place regulatory safeguards may, at best, help to mitigate such domination. They will not prevent it.

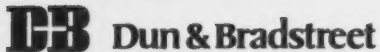
Third, accept the information transmission "gateway" concept, as defined by Judge Greene, as providing a reasonable balance between making available an efficient transmission infrastructure in this country while, at the same time, guarding against information domination by those who control the essential communication link between information provider and information customer.

Last, resist proposals to expand the functions of the information transmission "gateway" in ways that will unnecessarily increase the danger of anticompetitive behavior directed toward information providers, thereby ultimately harming consumers and business customers alike.

Thank you.

I would be happy to try to answer any questions you may have. Senator INOUE. Thank you very much, sir.

[The following information was subsequently received for the record:]



Michael S. Field
Vice President
Customer Information Systems

187 Danbury Road, Wilton, CT 06897
203-762-9512

Ms. Regina Markey Keeney
Minority Staff Counsel
United States Senate
Committee on Commerce, Science,
and Transportation
Washington, DC 20510-6125

February 16th, 1988

Dear Ms. Keeney:

Thank you for your letter of February 1st with regard to the question submitted by **Senator Pressler** regarding the Modification of Final Judgement. The following is my response to his concern regarding the need for a greater RBOC role in extending information services to all of the USA.

In order to provide comprehensive information services to rural, as well as urban America, a combination of capabilities needs to be put in place. Below is a list that generally describes these capabilities and my view on how they might be provided.

I would first, however, add that Judge Greene's September 10th, 1987, opinion would seem to remove any doubt that the Regional Bell Operating Companies (RBOCs) already have the authority to provide the necessary transmission network and transmission-related information services (with appropriate competitive safeguards). This means that they can now improve the transmission infrastructure to provide these capabilities to virtually all areas within their jurisdiction.

Moreover, if the RBOCs would move expeditiously to provide the transmission infrastructure, we would see even greater growth in **independent** information service providers, ranging from security monitoring, to health care information, to voice messaging, to a variety of database services. The large number of potential users would probably make such providers anxious to use this infrastructure to reach residential, small business and all other potential customers in urban and rural areas. This in turn would generate increased efficiencies and revenues for the RBOCs as the volumes increased and fuller use was made of their transmission facilities.

The RBOCs do not need to be in other information services, including content-based and electronic publishing ones, nor in long distance transmission or terminal equipment manufacturing, to ensure the widespread benefits of the emerging information age for all Americans. In fact, their quest to enter these other areas may distract their attention from their primary duties and business opportunities in providing the most modern transmission infrastructure in the world.

Moreover, were they to succeed in gaining authorization to enter these other areas without there being either the available technology that would dissolve the RBOCs local telephone exchange monopoly, or the existence of proven, effective, and enforceable regulations that would neutralize the anti-competitive capabilities of this monopoly, such entry would severely threaten the emergence and growth of an innovative, competitive electronic information services industry in the United States. Over time, it would almost certainly invite the fifth major antitrust dispute between the Bell Companies and the U.S. Government since 1913.

In the context of the preceding overview, let me summarize those capabilities that I referred to at the beginning of my letter. As I indicated, I believe these issues have all been addressed to some degree under the MFJ, as modified by the September 1987 court opinion.

1. A low-cost, compact, "telephone/video/computer" as customer premise equipment...

Today's low cost technology allows for the mass production of an intelligent, compact telephone with a screen, that could sit unobtrusively on the kitchen counter, for \$5 to \$10/month. Among the obvious suppliers (but not manufacturers) of such equipment could be **the RBOCs**, - a role they have had open to them under the MFJ since 1984, but have not yet chosen to play.

2. Local dialing into a communications network that is easy to use and access...

This capability already exists through the ubiquitous telephone network. Many companies have built data networks on top of this voice network to meet the needs of their customers (e.g. Banks, Insurance companies, GE, Dun & Bradstreet). Further, in the absence of a data friendly network from the Bell System, several companies have succeeded as general data network providers for both businesses and consumers (e.g. Telenet and Tymnet). As an aside, ATT tried and failed to provide such data networks with their NET/1 and NET/1000 offerings in 1981. This is the area **where the RBOCs have the right resources** to provide a competitive data network -- a pervasive high speed

data "highway," with easy on and off access ramps, and signposts. As long as they compete fairly, within the strictures and safeguards of the MFJ, their contribution in this area should be encouraged.

3. A range of information services and services of interest to the consumer and small business operators...

Except for the fact that they collect information as a by-product of their regulated businesses, the RBOC's have no particular strength to bring as an information provider; - either in content or data base management techniques. Moreover, because and so long as they have the local exchange monopoly, with the opportunity and motivation to discriminate or engage in anti-competitive behavior against other providers, they should not be allowed to offer content or database management services. If this monopoly is sufficiently eroded by either technological developments, (although, fibre optic links over the "last mile" would appear to be reinforcing the monopoly), or by successful, enforceable regulation, then the MFJ line of business remedies should and would be reevaluated under the terms of the MFJ decree.

Moreover, if consumers are to enjoy the fullest range of competitive, useful information services, it is important that subscriber listing information (that the RBOCs collect as a by-product of their telephone utility services) be made available on the same terms and conditions, and with the pricing cost-based, to all information service providers, not just to RBOC divisions and subsidiaries.

4. The existence of a billing system that can handle occasional low price transactions from a large number of geographically dispersed customers...

Small ad hoc billing can be achieved through two existing systems, -- the use of a personal credit card, processed by the information provider service, or by the RBOC on behalf of the service, - or, **by the RBOC** directly, accepting a transaction charge from the information provider and placing it on the customer's telephone bill.

5. A directory of services for those subscribers not familiar with what is available...

The number of services available in the USA is already very large and will grow larger. At some point, either an on-line directory or a printed directory would be needed to guide a user to a particular service. This could be provided either **by a RBOC**

subject to MFJ limitations, or by an independent company, as this is just another information database that would be offered over the transmission infrastructure. As with the airline owned electronic reservations display systems, there are risks to guard against in terms of biased listings.

In summary, there are areas where there is an opportunity and a necessity to leverage the RBOCs skills and resources in providing a world class, national data highway in support of new information services for both consumers and businesses.

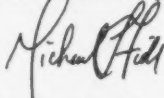
The RBOCs do not need to be information providers for rural as well as urban America to be served. They add no value that others could not provide. Indeed they must be excluded from the role of information provider as long as they retain the sole control over the final link with the subscriber. To do otherwise would reverse the progress made to-date by threatening to squeeze existing services out of the market, and discouraging the offering of new services by independent providers.

In a more positive vein, as discussed above, there are new offerings that the RBOCs could make in data transportation, low cost access equipment and economical billing, that would be major forces for change and innovation that would benefit all Americans in the information era. With specific reference to the Senator's question, these are the areas where the RBOCs can and should be contributing their strengths and skills. These are the obstacles to greater progress that need to be opened up by the RBOCs.

The opinions expressed are personal views and do not necessarily reflect the views of The Dun and Bradstreet Corporation.

I trust the Senator finds these comments helpful.

Yours sincerely

A handwritten signature in dark ink, appearing to read "Michael S. Field", written in a cursive style.

Michael S. Field

Needless to say, the debate has many complicated concepts, and for some, it is mind-boggling.

So, before I proceed with questions, I would like to ask a few fundamental, elementary questions.

What do you mean by "information services?" Somebody has to read the transcript, and I think that many of my colleagues may not get the full picture of what "information services" are.

Does anyone want to tackle that?

Mr. Cox. I would be glad to.

CompuServe provides presently over 1,100 information services. There are over 3,300, by our count, available in the United States. They range from the provision of data bases, like financial and news information, to bulletin board services, which allow the sharing of information among wide-ranging groups, like personal computing enthusiasts, financial information enthusiasts, hobbyists of different types, the handicapped, schools, educational professionals, health related items. So it is a combination of data bases and communication capabilities, electronic mail and conferencing, that make up the information services in the United States.

Senator INOUE. And these are presently available to the people of the United States?

Mr. Cox. Yes, Mr. Chairman, they are.

As I said, there are over 3,000 different services, data base services, as we count them. There are over 300 vendors today. It is a very robust business that is joined by companies like Dun & Bradstreet, General Electric, IBM, Sears, ourselves, Dow Jones, Lockheed, and several hundred local bulletin board services.

Senator INOUE. Who are the primary users, or the customers? Are they residential or business? What are they?

Mr. Cox. There is a mixture of both types. CompuServe's information service alone is used by over 400,000 individuals. We also have 1,300 business clients.

But I would stress that there have been over 15 million personal computers of all types, ranging from devices that are less than \$200 to very sophisticated devices in home—15 million, and 4 million modems, the equipment required for them to communicate, have been sold to homes.

So the users are of both kinds.

Senator INOUE. And these 4 million can receive the information that you have described?

Mr. Cox. Yes, sir.

Mr. DEMUTH. Mr. Chairman, may I supplement that answer?

Senator INOUE. Oh, please do.

Mr. DEMUTH. I think, while you may call that a generic question, it is really at the heart of the matter. There are as many answers to that question as there probably are panelists, and maybe far more.

The difficulty is that those who provide data bases in this country, the data base providers today, look at the answer to your question in terms of the data bases that they particularly provide and have available to the consumer. They presume that because people are literate in communications with computers that there is an information service base in this country that serves all the public. That is the very difficulty that we have with Judge Greene's ap-

proach to it, and the reason the MFJ, by being focused on the technologies of the seventies, misses the crux of the answer.

The answer is that information services to the judge is any enhancement of the present analog network that provides a voice communication to the American public. The universal, ubiquitous interconnectivity that is available in voice is not available to the public in respect to digital and computer communications. That is the difficulty.

The difficulty is that any enhancement of that network so that it is capable of providing for the universal, ubiquitous, interconnectivity and transmission of data in computerization is defined as an information service which is prohibited to the divested Bell operating telephone companies.

Therefore, the best answer to your question is that information services is any use of the network, any use of our communications infrastructure, which involves computers and digital transmission, practically, except for the operation of the network internally. And that is so restrictive that the American public simply does not have availability of the universal, ubiquitous, interconnectivity without the participation of the divested companies.

Senator INOUE. How do you use this network? The same way you use long distance companies?

Mr. DEMUTH. Yes.

You would use the network if it were enhanced for data the same way you use it for voice. That is the problem. We have to do that.

It is not a question of adding to the network something new. It is a question of using the capability, the computers we already have, to allow the public to utilize that in a way that is user friendly.

Senator INOUE. Let's say that someone is sitting in the back, here, and says I want to avail myself of this information that is now being discussed.

What sort of equipment would that person need?

Mr. DEMUTH. Depending upon the sophistication of the person, what we would hope is that a simple, dumb terminal, very similar to the dumb kind of terminals they have in the French Teletel system, would be adequate, or even the telephone.

There are lots of things that we could do with the telephone if we were permitted to do so. We could create the opportunity for the customer with the proper enhancement of the network to call in and leave a message if they were going to be late to an appointment or if it snowed in Washington and the Senate Committee wanted to substitute a time for a change. There you could call one number and provide that information so that everyone could call into one number.

We are prevented from doing that now in the information services restriction.

Senator INOUE. During one of my visits to an outlying island in my State, the island of Maui, I was given a demonstration of the French Minitel, from Maui. The question that they asked the machine was this. I live in Paris, I'm on my way to Marseilles, and I'd like to hitch a ride with someone. They put it in the machine, and in about two minutes it came out, "If you're interested, call this number. We'll be leaving at 9:00 o'clock in the morning."

Can that type of information be made available here?

Mr. Cox. Mr. Chairman, that type of information is available today through CompuServe. As a matter of fact, I had the pleasure of visiting Maui in the springtime, and accessed our service from there, and exchanged mail with my colleagues in Columbus and checked information locally from there as well. The type of capability you are describing, conferencing, is one of our most popular services today.

Senator INOUE. I have many other questions, but I will come back to them in my next turn.

I will call now on my colleague, Senator Packwood.

Senator PACKWOOD. Thank you, Mr. Chairman.

Mr. DeMuth, in answer to what the chairman just said and what Mr. Cox just answered, using the Minitel example and I want a ride to Marseilles, do I sense that what you are saying is this could be done better if you were allowed to do it, rather than a secondary source, like CompuServe, doing it?

Mr. DEMUTH. Yes, Senator.

I think that I'm saying that it could be done better, it could be done more affordably, and it could be done universally.

If the American public in general, in a nonthreatening way has access to this kind of availability as a public utility service, where they don't have to be computer literate, where a friendly, dumb computer, where the public utility can provide the sophisticated, complicated processing of the information in the network, so that it is possible for everyone, those who are computer literate and those who are not, to access these kinds of services, inexpensively and universally, that is what we are talking about.

Of course, I think one of the things that must be realized is we need a critical mass of information providers or conduit, so that all of the public has the variety of services they want. They will never get that through the specific focus kinds of data base suppliers we now have.

Senator PACKWOOD. I am curious if Mr. Cox would respond to what Mr. DeMuth says, that they can actually do it better than you can do it.

Mr. Cox. Senator, I would add that Judge Greene's provision to have the BOCs provide transport is aimed at providing an increased ease of use on the methods that are available today. And so, his ruling provides for that.

I would also add that I don't know of any services that are available anywhere in the world that are not available within the United States, either in a very similar fashion or that very easily could be added with the technology that we have.

So I would stress that the availability and the ease of use is there today, at an affordable price, and that Judge Greene's recent ruling takes it further, to allow the BOC's to enhance the transport to those serviced to make them even more accessible.

Senator PACKWOOD. But you would contest what Mr. DeMuth said, that they can do it better than you can do it?

Mr. Cox. Yes.

I don't know what they would do that would be better than the technology that is there.

Senator PACKWOOD. Mr. DeMuth, let me have you come back now. CompuServe says no, you can't do it any better; just give us access to the transmission facility and we can do it as well as you can do it.

Mr. DEMUTH. I suppose, in a technological sense, we all have the same technology now, and strictly from that perspective I suppose they can do it as well.

They don't have the universal, ubiquitous, interconnectivity. They don't have the critical mass that allows all the public to utilize the facilities. It is like a snowball. It is cumulative.

Senator PACKWOOD. I am confused. You have the critical mass because you have the wires to everybody's home.

Mr. DEMUTH. That's right.

Senator PACKWOOD. But you have to attach something to the wire to provide a service, whether it is a computer or whatever else you attach to it.

I don't understand the critical mass argument. If the critical mass is the wiring, you are the only critical mass.

Mr. DEMUTH. Right.

Senator PACKWOOD. If the critical mass is the service to be added to the wiring, you have to attempt to sell the customer, or CompuServe has to sell the customer, or somebody else has to sell somebody on buying the service, don't they?

Mr. DEMUTH. That's correct.

Senator PACKWOOD. So I don't quite understand the critical mass argument.

You both have the problem of creating the critical mass, don't you?

Mr. DEMUTH. We have the critical mass.

Senator PACKWOOD. I mean the critical mass customers.

You have the critical mass in the connections.

Mr. DEMUTH. That's right, and we are prevented from making the technology available to that critical mass under the information service restrictions.

Senator PACKWOOD. I understand that.

Mr. DEMUTH. We don't have to add computers to our network.

Senator PACKWOOD. That's what I was wondering.

Mr. DEMUTH. We already have computers. We already have the technology. We cannot provide the data base manipulation and the data base transport that we need to under the restrictions in the consent decree.

Senator PACKWOOD. I'm not asking my question right, I think.

You say you don't have to add computers; you already have them.

Mr. DEMUTH. Yes.

Senator PACKWOOD. You have to have computers connected to the lines. The lines themselves are not going to do the work.

Mr. DEMUTH. Telephones, in a sense, are computers. Telephones are simple computers.

Senator PACKWOOD. I understand that.

Mr. BOREN. Senator, perhaps I could address the critical mass question in a little bit different way.

The ubiquity of the network is one thing. That provides obviously transportation ease, efficiency, and all of that. But the thing that

we have to do in the country is get a critical mass of services that people—

Senator PACKWOOD. A critical mass of what?

Mr. BOREN [continuing]. Of services that people find attractive enough that they will want to pay for it.

Now, CompuServe is an excellent company. They have about 370,000 customers. I have 15 million customers in Bell South.

The issue is how do we get the richness of what CompuServe and a lot of other information services provide to the masses of the people in rural areas and small towns.

Our concept is to use the network, with all of its functionality, to allow any kind of terminal, from the dumbest to the smartest, to access it, to put all of the services available on a "gateway" with an inventory, with the type services they provide and the prices that they charge, push a couple of buttons and you can navigate the system and get to any of them.

If we can get that, that is going to foster lots of other entrepreneurs to create services to go the network.

Senator PACKWOOD. But I don't sense that CompuServe or the American Newspaper Publishers Association is disagreeing with that. On the screen there are 4,500 services available.

Mr. Martz, I don't misstate it, do I? You don't object to that, and I don't think CompuServe does either.

Mr. MARTZ. We don't disagree with it.

Our concern is this. Once the BOCs cross the line from transport to content, then they are competing with an unfair advantage because they own the local line in providing services.

Senator PACKWOOD. Well, here is what I am trying to get at, and I am not asking it right.

Do I understand, in terms of using the expression "voice storage," that you could replace what is a normal answering machine that people have in their businesses?

Mr. BOREN. That is one of the things that you could do with it, yes, sir.

Senator PACKWOOD. Now, you have 15 million people out there that you would like to sell the service to, if you could.

Mr. BOREN. Correct.

Senator PACKWOOD. Let's say CompuServe is in the same business.

Are you in the answering machine service, Mr. Cox?

Mr. Cox. We are in the electronic mail business, which is similar. But no.

Senator PACKWOOD. All right.

What I don't understand is what Mr. DeMuth says, that there is a unique advantage in the RBOCs that would allow them to do this answering voice storage service better than CompuServe or somebody else who wanted to be in it.

Both of you have to use your lines to get to the 15 million customers. You have to sell those 15 million on doing it.

What enables you or U.S. West to do it better than CompuServe?

Mr. BOREN. I think two considerations, Senator. Large businesses, sophisticated customers, have that type of service today if they want it. They buy an answering machine, usually manufactured offshore, and they install it in their home or their business.

There are lots of people who do not find enough use for that or are in such a small town or a rural part of the country that nobody is out there making them aware of the service.

We are there. We have people there, we have business there, and we could provide the service very easily and very efficiently over the network.

That is the issue. And not only the storage, the voice storage, but the services we are talking about——

Senator PACKWOOD. Excuse me. Let me back up.

Technically, the answer you are giving me is that you are simply more pervasive. You exist every place, with regional managers every place, and people that belong to the "United Good Fund Board" every place, and literally have an infrastructure that makes you in a better position to sell the services. You have more contacts.

What I am trying to find out is: are the services any better?

Mr. BOREN. Yes, sir.

Senator PACKWOOD. Oh, they are? OK.

Mr. BOREN. The problem we are having here is we are talking about an answering machine, which is really a low level technology.

Now let's get to a system where you are using remote energy management for your home to shed off-peak power for the power company, where they can adjust their rate structure to encourage you to remotely use their power at a time it is easier for them to provide and cheaper for you to pay for it.

Now, when you start getting into those kind of services in the home, that is where we can add value.

Senator PACKWOOD. I want to ask Mr. Field. Can they provide the services better than you can provide them? Assume you have the same access to their lines. Can they do it better than you can do it?

Mr. FIELD. Well, we don't believe so.

We think the trend to put and cement more and more capabilities into the network takes away from the opportunity to be innovative in either the terminals that are in the home or in the provision of information services in the host data base machine. I think that is one of the weaknesses with the Minitel system. It was a successful experiment for France, but it is a fairly rigid system.

I think if the Judge Greene recommendations go forward, we will, in fact, have the RBOC's in a position to provide a smoother data highway, an interstate highway, in which we can all participate and they can provide easier access ramps onto that interstate data highway.

That is what we want. I think the ruling, the order, provides for that. What we don't want and what we don't see as added by the RBOC's is what they might provide in terms of information content. We don't see that that enriches it any more than what the current population of information providers does.

Senator PACKWOOD. Mr. Martz, let me ask you a question.

When the Commerce Committee was initially going through the restructuring of AT&T and we passed a bill before the consent decree, we restructured AT&T, we didn't break it up in this fashion. But this issue of information services was an issue.

I recall three people from the American Newspaper Publishers Association coming to see me, two of them explaining some technical detail of why they didn't want the phone companies in content. But it was a rather obtuse explanation.

Finally, the third one said oh, for goodness sake, what we are afraid of is they are going to put the classified advertising on the television and we will go bankrupt.

Well, you know about the old story that nobody ever explained it to me that way before.

But I don't sense that fear this time.

You don't want them in the content business, but I don't sense you have the same fear that you did, of your classified advertising being on television rather than in your papers.

Mr. MARTZ. I think the focus of the discussion is really pointing to where the rubber hits the road.

The term "information services," under the MFJ, has a whole set of generic meanings that are different than some of the terms as they have been used here now.

Under the MFJ, information services, as Mr. DeMuth stated, cover the whole gamut of doing anything different to something going over the network, and under Judge Greene's order, the subset of that was electronic publishing, which was basically content-oriented, and involved any compilation, editing, authoring, presentation, prepackaging of the data, and giving it to an unaffiliated third party and having a financial interest in it.

The information services per se are, in our minds, the content-based services. This is where we think Judge Greene's order really cuts it where it should be cut.

Senator PACKWOOD. Is classified advertising a content service?

Mr. MARTZ. Classified advertising is a content-based information service. But Judge Greene's order provides for enhancing the "gateway" functionalities so that I, as a newspaper, or CompuServe, or Dun and Bradstreet, or anybody can have access to the end consumer much easier than we can now, with the lack of that infrastructure.

In the sense of classified advertising, certainly as a publisher in Pottsville, Pennsylvania, I have absolutely no concern if Bell South were to come into Pennsylvania and try to set up an electronic classified advertising base. I would have a great deal of concern if Bell Atlantic were to do that because Bell Atlantic still has control of that network that I have to use. It is the only game in town and is the person who owns the wires that go into the individual household.

Senator PACKWOOD. Let me ask one last question, Mr. Chairman.

From the standpoint of the classified advertising, I don't quite understand the distinction in the fear, because if there is a fear that you will lose tremendous revenues, if not Bell South going into Bell Atlantic's area, what I would picture is some 33-year-old marketing whiz at one of the companies who has an MBA from Harvard and she's been with this company 8 years, and she thinks to herself I can make myself a pot-full of money by quitting this company and going into the classified advertising business on television. And she quits, and raises whatever capital she needs, and does the thing that I thought the papers were afraid of.

Mr. MARTZ. What we were afraid of was if anybody were to do that, that they had an equal shot as we had; that the level playing field would be there; that if they had access to the telephone network, we had the same access. This is because when you own that bottleneck, when you have control of that network and those twisted pairs of wires, subconsciously, covertly, or just inherently you have an advantage.

That is what we were afraid of, and still are.

Mr. Cox. May I just add that within the entire industry, I think that is the concern. As long as everyone has a fair opportunity to use the lines, a fair access, we cannot say that we are not willing to compete. We are all willing to compete and, in fact, say there is robust competition today.

But, when the people who control the critical access to the consumer are competing with us, then there is substantial vulnerability.

Senator PACKWOOD. Thank you, Mr. Chairman.

Senator INOUE. Thank you.

It has been suggested that, with the limited dollars we have, and by being seduced by these strange diseases, rare diseases, and spending large sums of money on that, the people of the United States are being denied basic health services.

In the same sense, a concern that many of us have here is that by being seduced by all of these sophisticated information services, mind-boggling possibilities, what will it mean to the consumer? Will they be denied basic services? Will the basic services, telephone services, be much more expensive?

The average American is not going to be subscribing to Dun and Bradstreet or to commodity information.

Mr. BOREN. If I could comment on that, Senator, I think from two standpoints, first of all, I don't see any relationship in the danger of telephone service being denied to the issue that we are talking about today.

The telephone system in this country, as you well know, now serves a greater percentage of the population than before, and is available generally throughout the country at very reasonable prices.

The other issue that you mentioned is customers not needing or wanting information services.

I certainly agree with you that the average American will not subscribe to Dun & Bradstreet. That is mostly a business service.

But I am persuaded that if I am in a small community or a large community, and I am in need of frequent drugs, if I do not have travel opportunity available to me and I would like to have home grocery delivery and shopping at the cheapest price, I am persuaded that there are a lot of people who would be served by those kinds of services that would make their lives better and easier, and the country would benefit by having the flexibility to develop those services.

We have in this country, as the gentlemen have mentioned, a very high quality, national data base of information. What we don't have is local development of that market, and the development of local services that can aid a person's life.

This transformation of our country is going to happen over the next 10 or 20 years. It is inevitable.

The speed at which it happens will benefit us all if it is quicker, rather than later.

Senator INOUE. Most Americans I think would have some difficulty understanding what we are talking about today, and I suppose they could care less, also.

In the same sense, I believe that most Americans, when they were made aware of the breakup of AT&T and the headlines were that the monopoly is going to be broken up, you will have more competition, more people moving into the scene, I think most Americans anticipated that the cost of telephone service would be coming down. I think that is a natural inclination or assumption.

Now, in this case, what should the average American or the consumer anticipate, really?

Mr. BOREN. If I could, I would comment from two points of view.

Senator INOUE. If Judge Greene's decision is to let you folks in, that is.

Mr. BOREN. If we are allowed to be in that business without restriction, particularly in how we go about transporting the information, no restrictions on what kind of protocol conversions and speeds of transmission and all that, but just how do you get the information most efficiently from Point A to Point B and make it transparent to any kind of terminal, to any kind of computer, then what that does is that puts more usage over the existing public switch network, using the network and the inherent smart capability that it has to use digital information as well as voice communication.

If that has any impact on the economics, then it reduces the burden of the overhead of the network that everybody on it has to share.

It is the same argument that any business understands when you try to increase the usage or the base or the market share over which you have to spread overhead costs. The customer would benefit from that.

The provision of information, the content piece of it, of course, is the other question. It is widely believed, obviously, that if we were allowed to provide content, we would somehow be motivated to monopolize that industry.

Nothing could be further from the truth.

It is to our advantage to encourage as many information services on the network as we possibly can. Do we want to be one of those? Yes, and for the reasons that I mentioned to Senator Packwood earlier. This is that we are a very, very technical company in the information business, and, given the freedom, we can create products that Americans will find useful and helpful.

Senator INOUE. Mr. Kimmelman.

Mr. KIMMELMAN. I would like to respond, Mr. Chairman.

Certainly if we could get basic phone service cheaper and we could get new services with prices coming down, consumers would not be against that. It is not a problem to us at all.

Unfortunately, what we have seen since the divestiture is the opposite, in terms of prices. As far as we can tell, the issue of sending more messages through the system saving money is a good concept.

It is an issue of who makes the money, not whether that can save money because, with rates going up, we cannot see that the regulatory process has been driving down the costs for consumers.

I think that this whole argument on information services is getting a step away from the reality of where our society is with communications.

Yes, if we talk about the need for a computer, as you indicated, Senator Packwood, we are talking about a fifth of this country right now having access to computers to get many of these services.

Now, as Mr. DeMuth indicated, a telephone is a sort of computer, and many Americans have telephones—about 98 percent of people above the poverty line. But only 80 percent of people below the top poverty line even have a telephone. About that many minority households have a telephone, a quite cheap instrument.

We are talking about things that cost money that many people cannot afford or cannot afford to divert their meager resources to buy.

Our main problem is not the question of who is technologically better, who can provide a better service.

I frankly don't know, Mr. Chairman.

Our concern is, can it be provided at a fair price, and will the price of what Americans really need, basic voice telephone service, go up or go down.

I was intrigued to hear Mr. DeMuth describe the functions for information services as functions that a "public utility" can provide better. If that is so, if this is really a monopoly, we certainly believe the monopoly Bell companies, regulated like monopolies, ought to be allowed to provide them as monopolies.

Our understanding, though, is many of these are competitive, and my concern is, this is the first time I have heard someone from U.S. West describe itself as a "public utility" in a long time. Everywhere else I go, they are describing themselves as a competitive firm, and it worries me that, with weak regulation, a history of regulation that has not been able to prevent subsidies, we risk significant increases in our basic telephone rates for a promise that there may be some things that certain companies can do better than others.

I don't believe that that is a risk worth taking.

Senator INOUE. Thank you.

Do you have any further questions, Senator Packwood?

Senator PACKWOOD. No, thank you, Mr. Chairman.

Senator INOUE. Unfortunately, I have another appointment and another hearing to attend.

As I indicated earlier, the record will be kept open, so if you have additional views, additional statements, documents, exhibits to submit, please feel free to do so.

Therefore, with much gratitude, this hearing will stand in recess until our next hearing.

[Whereupon, at 12:43 p.m., the subcommittee adjourned.]



ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF O. GENE GABBARD, CHAIRMAN OF THE MANAGING COMMITTEE, NATIONAL TELECOMMUNICATIONS NETWORK

The National Telecommunications Network ("NTN") welcomes this Subcommittee's inquiry into the status of the Modification of Final Judgment. NTN strongly supports the MFJ and the critical competitive safeguards it provides. We urge the Subcommittee to stand firm against the BOC's continuing attempts to water down or wash away those safeguards. A strong stand by this Subcommittee will lead directly to lower rates for consumers by deterring improper long distance network construction by the BOCs, and facilitating the development of full competition with AT&T.

NTN is a joint venture of seven companies that collectively have invested approximately \$1 billion to construct regional fiber optic networks. Through NTN, the regional networks have been interconnected to form a nationwide network serving more than 80% of the metropolitan areas and over 90% of the population of the country. The seven members of NTN are: Microtel, Inc., Boca Raton, Florida; SouthernNet, Inc., Atlanta, Georgia; Consolidated Network Inc., Mattoon, Illinois; Litel Telecommunications Corp., Worthington, Ohio; Southland Fibernet, Inc., Pensacola, Florida; Williams Telecommunications Company, Tulsa, Oklahoma; and LDX NET, Inc., St. Louis, Missouri.

The NTN transmission capacity is both a product of divestiture and vital to divestiture's success. NTN competes directly with AT&T in the private line market, and some members also provide switched services. But equally important, NTN provides bulk transmission capacity to a large percentage of AT&T's other competitors, most of whom were dependent upon the resale of AT&T services prior to divestiture. We thus are helping meet the Consent Decree's purpose (to quote the Court) of "effect[ing] a change-over from the AT&T de facto monopoly to be a competitive interexchange market."

As the Subcommittee knows, the MFJ follows from extensive evidence that the old Bell System used its monopoly control of the local telephone network to block competition. NTN members, for example, have no choice but to use Bell Operating Company access facilities to connect their fiber networks with their customers. The MFJ does not eliminate the ability of the BOCs to disrupt our business through high access prices, low service quality, or general lack of cooperation. But at least the MFJ reduces the BOCs' incentives to do so by barring the BOCs from providing long distance services themselves.

NTN participated actively in the triennial review proceedings held this year by Judge Greene. We are relieved but not surprised that the Court rejected BOC requests for elimination of the long distance prohibition of the MFJ. Even the Justice Department agrees that this restriction continues to be necessary. All parties except the BOCs recognize that the BOCs retain bottleneck control over the local exchange, and that no change in the long distance prohibition is appropriate until the bottleneck is substantially eliminated. Realistically speaking, such a revolutionary change in local telephone service is not on the horizon.

NTN's comments to the Court focused on evidence that, notwithstanding the MFJ prohibitions, the BOCs already were preparing to provide long distance service at ratepayer expense. As early as 1984 the Court had noted that "even to leave open the possibility of Regional Holding Company entry into this market would have negative implications" for ratepayers and competition. The Court observed that if the BOCs "perceive themselves as future long distance competitors, they will have incentives to spend ratepayer funds for long-distance network construction." Similarly, the Court foresaw that the BOCs also would have incentives "to position themselves for successful entry by discriminating against other carriers in interconnection," that is, through their control of necessary access facilities.

For these reasons the Court has tried to be clear and firm so that it would not "leave open the possibility that the BOCs might be allowed to provide long distance services while their bottleneck continues. But unfortunately, the BOCs apparently hope or expect that the MFJ will be gutted prematurely anyway. This is the

only possible explanation for the fact that they have spent hundreds of millions in ratepayer funds on long distance network facilities—just as the Court feared. For example, an FCC report has found that through 1986 the BOCs already had installed several times the total long distance capacity that AT&T had at divestiture in 1984. The FCC report politely states that “[t]hese findings were somewhat surprising in light of the fact that the Bell Operating Companies’ operations up to now have generally been limited” by the MFJ. Yet so far as we are aware, neither the FCC nor the Justice Department has investigated this massive and otherwise unnecessary investment. Consequently, consumers are now paying for the investment in their rates.

Similarly, the BOCs are using their control of the local network to discriminate against carriers that they perceive as their future competitors. This problem is particularly acute for the point-to-point “special access” upon which carriers like NTN rely. Our customers are individually identifiable to the BOC because we connect directly over a specific BOC circuit to our customer. If that circuit is installed late or service “fails,” the customer has no backup and we lose revenue and good will. If that circuit is over-priced, customers are less willing to take our service.

NTN urges the Subcommittee to stand with the Court and the overwhelming consensus of interested parties and make clear its support for the long distance prohibition of the MFJ. This Subcommittee should take care (to repeat the words of the Court) not “even to leave open the possibility of Regional Holding Company entry into this market.” Only such firm support for the competitive safeguards of the MFJ will at last encourage the BOCs to help facilities interexchange competition—instead of using ratepayer funds to prepare to enter the market themselves.

STATEMENT OF THE COMPETITIVE TELECOMMUNICATIONS ASSOCIATION (COMPTEL)

INTRODUCTION

The Competitive Telecommunications Association (COMPTEL) is the principal industry association representing long distance telephone companies on public policy and regulatory matters. Our members include some 150 companies offering competitive choices in long distance services to business and residential customers in all parts of the nation.

While the largest long distance companies offer service nationwide, many other companies offer quality services originating in distinct regions of the country or even in just a few localities in a single state. All of these companies, regardless of their size have made a substantial commitment to bringing the benefits of new choices, greater efficiencies and innovative technology to the American consumer. The newly competitive long distance industry includes companies making substantial investments in fiber optic, digital microwave and other transmission facilities. They provide economical alternatives to end users by aggregating demand for long distance capacity. They also offer flexibility and personalized attention to technical needs and account servicing, made possible by operating closer to the customer.

I. COMPTEL SUPPORTS THE INDUSTRY STRUCTURE ESTABLISHED BY THE MFJ

COMPTEL strongly supports the decision issued by U.S. District Court Judge Harold Greene last September on the occasion of the first triennial review of the Modification of Final Judgment (MFJ)—the settlement agreement that resulted from the historic AT&T antitrust case. *U.S. v. Western Electric*, Civ. Action No. 82-0192 (D.D.C. Sept. 10, 1987). By accepting divestiture and the line of business restrictions on manufacturing, interexchange (long distance) and information services, the Bell System avoided potentially harsher penalties for anticompetitive abuses. Central to the theory of divestiture was the fact that vertical integration of local monopoly and long distance operations gave the Bell System irresistible incentives to use its bottleneck control over local distribution facilities to disadvantage long distance competitors.

To prevent the recurrence of such anticompetitive abuses, the MFJ prohibits entry by the BOCs into traditional (inter-LATA) long distance operations. The divestiture agreement further provides that the “inter-LATA” restriction may not be removed or waived until the Court finds that there remains *no* substantial possibility that the Bell Companies would impede competition in the long distance industry. *U.S. v. American Tel. & Tel. Co.*, 552 F. Supp. 131, 231 (D.D.C. 1982), *aff’d mem. sub nom. Maryland v. U.S.*, 460 U.S. 1001 (1983).

The 1987 triennial review of the MFJ demonstrated conclusively that the legal and economic prerequisites for removal of the core line of business restrictions have not

been met. Given the dependency of all interexchange carriers on the bottleneck monopoly local distribution networks of the Bell Operating Companies (BOCs), an absolute prohibition on vertical re-integration by the Bell Companies was and is the only sure way to keep the anticompetitive incentives of these monopolies in check.¹

II. POTENTIAL FOR MONOPOLY ABUSES REQUIRES RETENTION OF THE LONG DISTANCE RESTRICTION

The seven Bell Regional Holding Companies and more specifically their 22 Bell Operating Companies are monopoly providers of local exchange service upon which long distance competitors must almost totally depend for origination and termination of their traffic. This monopoly position is augmented by the geographic concentration of the Bell Company service territories. In spite of the break-up of the old Bell System, the Bell Regional Holding Companies retain enormous economic strength—each of them ranks among the twenty-five largest corporations in the country. Without the MFJ restriction, the BOCs would continue to have unquestionable incentives to abuse this monopoly position and market strength to the detriment of long distance competitors.

Access discrimination

Long distance companies must buy exchange access service from the BOCs in order to originate and terminate virtually all telephone calls. If the Bell Companies were allowed to compete for this long distance business, they would have an overwhelming incentive and opportunity to use their monopoly control in order to discriminate against long distance competitors in the provision of access service. When a sole source supplier becomes a direct competitor, all other competitors can be held hostage by that monopoly supplier. This situation, which led to the Bell breakup and the imposition of the line of business restrictions, is as real today as it was when AT&T abused its monopoly.

Even though the MFJ industry structure prohibits vertical re-integration by the BOCs, the Bell Companies have little incentive to provide quality exchange access services to long distance companies. These companies have no choice but to purchase exchange access services from the BOCs regardless of the quality, which is today unsatisfactory in spite of equal access obligations. As direct competitors, the Bell Companies would have strong incentives to degrade even further the quality of access services provided to long distance competitors.

Discrimination could also take the form of Bell long distance operations getting priority over competitors in the provision of access. Competitors would suffer delays and degradation in installation, interconnection and maintenance, with the end result being lower overall quality as perceived by the customers of competing long distance services.

Furthermore, as the exclusive repository of complete information on all telephone customers in their regions, the Bell Companies would also have an enormous marketing advantage over their competitors. They would be able to use their information on the relocation plans of large business customers, for example, as well as the daily usage patterns of all customers to advantage their own long distance operations.

Thus, exclusive BOC control over the local telephone network and proprietary customer information, combined with massive regional market concentration, give the BOCs the ability and incentive to disadvantage competitors or even to ban them entirely from some of their most cherished markets.

Cross-subsidization

Congress and the FCC have long recognized that monopolies have a strong incentive to subsidize their competitive offerings with monopoly revenues. Such cross-subsidization is generally accomplished by shifting costs from competitive services to regulated monopoly services. As a result, competition suffers due to predation and captive consumers of monopoly services are subject to price gouging. This problem was recently highlighted by audit reports of the BOCs conducted by the National Association of Regulatory Utility Commissioners (NARUC), and by an October 1987 Report issued by the U.S. General Accounting Office. The GAO study concluded that the FCC's program of cost accounting reports was wholly inadequate to prevent cost-shifting (cross-subsidies) that would force local telephone customers to pay for BOC corporate diversification into discretionary lines of business.

¹Structurally separate subsidiaries for competitive businesses have been rejected by the BOCs and by the FCC as too cumbersome and inefficient. *Third Computer Inquiry*, 104 FCC 2d 958 (1986).

Current developments demonstrate the BOCs' tendency to misuse rate-base revenues merely *in anticipation* of providing interexchange services. Since divestiture BOCs have made substantial investments in facilities (inter-LATA fiber), marketing (long distance calling cards), and database development (LIDB, 800 services, operator services), all of which are needed to support full scale Bell interexchange services. Most of these development costs are being borne by the captive local telephone ratepayer, a classic example of cross-subsidization of competitive or potentially competitive services by monopoly services.

Affiliate transactions also represent cross-subsidies. For example, the staff of the California Public Utilities Commission has found that Pacific Telesis used in unregulated ventures personnel who had been trained and who had developed expertise while salaried within the regulated rate-base without adequate compensation to the regulated monopoly business.

Cross-subsidies have always been a concern in the regulation of monopolies. Direct involvement of the BOCs in the competitive long distance market would provide the greatest opportunity in memory for this problem to run wild. The only sure means to prevent such abuse of ratepayer funds is to retain the MFJ's ban against vertical integration.

III. BOCs CURRENTLY ABUSE THEIR MONOPOLY POWER

As discussed above the current condition of the marketplace provides substantial opportunities for the BOCs to operate in an anticompetitive manner. Even without providing traditional long distance service, the BOCs have found ways to exploit these opportunities to disadvantage competitors.

Intra-LATA toll

The MFJ established artificial geographical boundaries ("LATAs") within which it is permissible for the BOCs to provide long distance service. This "intra-LATA" market is very substantial, accounting for over 30 percent of the total long distance market. However, while the "inter-LATA" market is subject to increasingly fair competition, the intra-LATA market is not. This is a direct result of BOC monopoly abuses.

While advocating less regulation and more competitive opportunities for themselves, the BOCs have adamantly opposed and successfully prevented real intra-LATA competition. Despite the federal requirement for inter-LATA equal access, the BOCs refuse to provide 1+ calling capabilities (the most important feature of equal access) for their authorized *intra-LATA* competitors. Instead they "strip" intra-LATA calls for presubscribed customers, carrying and billing that traffic themselves rather than routing it to the customers' designated carriers.

Other BOC business practices serve to discourage such competition as well. For example, BOC-provided Centrex facilities are designed to favor BOC intra-LATA services. Bell Companies refuse to route the interexchange traffic of their Centrex customers to the customer's carrier of choice. The Bell Companies have also balked at allowing their WATS access lines to be used for mixed intra- and interstate calling, even though long distance companies have requested the service, there is no technical reason not to provide it, and the FCC has ordered provision of the service. Instead the BOCs have lobbied state regulators to circumvent the FCC order by adopting state orders prohibiting such mixed-use access lines.

Access charges and facilities

Another example of current discriminatory and anti-competitive practices of the BOCs arises specifically in the context of their provision of access and the charges therefor. Cases have been made against several BOCs for their pricing strategies whereby long distance competitors are forced to pay more for access, i.e., the local interconnection portion of a long distance call, than the BOC charges its own customers for a complete intra-LATA call (including both local interconnection and long haul portions). Southwestern Bell was rebuked by the Texas Supreme Court for such pricing policies.³ Similar claims are pending against Pacific Northwest Bell in

³ *AT&T Communications of Southwest, Inc. v. Public Utilities Commission of Texas*, 735 S.W. 2d 866 (Tex. Civ. App. 1987).

Washington and Oregon⁴ and against Mountain Bell in Colorado⁵ and were also raised against Mountain Bell in New Mexico.⁶

IV. THE INTEGRITY OF THE INTEREXCHANGE PROHIBITION MUST BE MAINTAINED

Judicial imposition and interpretation of the MFJ prohibitions against vertical integration fall well within the Court's authority and indeed duty to enforce federal antitrust laws. Thus, the prohibition against BOC provision of interexchange service was clearly required by market conditions existing at the time of divestiture and continue to be justified today.

The waiver standard must be maintained

As discussed before, the standard for elimination or waiver of the interexchange prohibition is the same: there must be *no* substantial possibility that a Bell Company could impede competition in the market it seeks to enter. The Court has ruled that the waiver standard cannot be met for domestic telecommunications markets so long as the BOC local exchange telephone monopolies persist. *U.S. v. Western Electric*, Civ. Action No. 82-0192, slip op. at 51 (D.D.C. Sept. 10, 1987). Given the findings of the Department of Justice and its consultant Peter Huber relative to the condition of the local exchange marketplace, i.e., that no serious competition with BOC networks exists,⁷ waivers of the interexchange prohibition are completely inappropriate. Close scrutiny of any such waiver requests is required.

Information service developments should not circumvent the interexchange prohibition

The Bell Companies may be expected to take advantage of any ambiguity in the wording of Court orders and regulatory guidelines on information services to enter prohibited interexchange service markets. Therefore, the FCC should be vigilant in its oversight of any new BOC involvement in information services—not only on the question of whether access for competitors is sufficient, but also on the question of whether the BOCs are offering and controlling interexchange functions in the process. For example, in the case of information service functions the BOCs may be allowed to offer, inter-LATA carrier selection by the BOCs should be prohibited because it would put the Bell Companies squarely in the interexchange business between the end user and the information services vendor.

CONCLUSION

Interexchange freedom for the Bell Companies should remain out of the question as long as the local exchange bottleneck persists. The potential for access discrimination and cross-subsidization are simply too great. These classic problems of anti-competitive behavior along with the huge intrinsic market advantages in technical control and customer information underscore the wisdom of the MFJ prohibition against vertical re-integration by the BOCs. Any weakening of the MFJ provisions on long distance would only invite more egregious anticompetitive abuses by the Regional Bell Companies.

STATEMENT OF PACIFIC TELESIS GROUP ON THE MFJ RESTRICTION ON INTEREXCHANGE SERVICES

INTRODUCTION—THE MFJ INTEREXCHANGE SERVICES RESTRICTION

Pacific Telesis Group is one of the seven Regional Holding Companies (RHCs) which were created by the break-up of the Bell System in January of 1984. Since their creation, the RHCs have been restricted from offering interexchange services, from providing information services and from manufacturing telecommunications equipment. These three restrictions are contained in the Modification of Final Judgment (MFJ) which was entered by the United States District Court for the District

⁴ *American Network, Inc. v. Pac. N.W. Bell Tel. Co.*, No. C86-676. (W.D. Wash., filed June 2, 1986).

⁵ *Colorado Municipal League v. PUC of Colorado*, No. 87 CV12686 (Dist. Ct. Denver, filed June 30, 1987).

⁶ Petition by Mountain Bell for a Determination that Intra-LATA Toll Services are Subject to Competition, NM Corp. Comm. Docket 1142 Consolidated (Feb. 13, 1986).

⁷ Dr. Peter W. Huber, *The Geodesic Network: 1987 Report on Competition in the Telephone Industry* (January 1987) at 1.8, 2.12, 2.23, 2.25 and 3.9 Table IX.5.

of Columbia (District Court or Court) which has continuing jurisdiction over the MFJ and is presided over by Judge Harold H. Greene.

As part of the triennial review of the MFJ, the District Court issued an Order on September 10, 1987, retaining all three of these restrictions. The only relief granted by the Court was the determination that RHCs would be allowed to enter non-telecommunications businesses without waivers from the Court and without Court mandated conditions (e.g. the revenue limit has been removed) and to provide transmission type information services to be defined by the Court based on further comments by parties.

Pacific Telesis believes that all of the MFJ restrictions should be removed. The purpose of this statement is to discuss the reasons why removal of the interexchange services restriction would benefit the American public.

This restriction generally confines RHCs to providing transmission services within exchange areas known as local access transport areas (LATAs) which were created by the District Court after receiving comments from various parties. The telephone companies of the RHCs may not carry communications across these exchange or LATA boundaries but must hand interexchange communications off to, or receive them from, interexchange carriers such as American Telephone and Telegraph Company (AT&T), MCI, and US Sprint. Thus, RHCs are limited to providing intraexchange services and to originating and terminating other carriers' intrastate interexchange communications and interstate communications. RHCs are not allowed to compete in the interexchange market.

Questions concerning who should be allowed to offer telephone transmission services, and what conditions should be placed on such offerings, go to the heart of federal and state regulation of communications common carriers under the 1934 Communications Act and state statutes. This regulation has been established in order to ensure that all citizens have access to rapid, efficient and ubiquitous communications services that are high in quality and reasonable in price. Because of the importance of these services to the public interest, they have traditionally been regulated by public officials who are responsible to representatives elected by the people.

The MFJ restriction on interexchange services stands directly in the way of comprehensive and cohesive regulation of these matters by excluding from interexchange markets the companies that provide the telecommunications infrastructure for most American consumers and businesses. The restriction should be removed in order to transfer jurisdiction over these services back to the appropriate regulatory agencies—the Federal Communications Commission and the state public utilities commissions—with Congress once again setting national telecommunications policy for the benefit of all Americans.

THE RESTRICTION PREVENTS THE BENEFITS OF COMPETITION

The Bell System was broken-up four years ago in order to ensure the development of competition in telecommunications markets. As part of the break-up, the RHCs were ordered to create equal access to their public telecommunications networks for competing interexchange carriers. According to the estimate of an analyst with the National Telecommunications and Information Administration, about \$4.5 billion received from ratepayers has been spent to substantially achieve this equal access, but fewer than 20% of all subscribers have chosen a carrier other than AT&T.

Consumers have not been offered an adequate choice of carriers for their long distance communications. Only three facilities-based carriers serve nation-wide, and only three others serve as many as 25 states. (FCC figures of November 12, 1987.)

AT&T and MCI have asserted that interexchange rates have dropped dramatically, and they have implied that this drop is due to competitive pressures. But in its annual report to shareholders, AT&T admits that it was regulation, but competition, that forced reduced prices:

"Service revenues rose due to growth in long distance calling volumes, stimulated in part by AT&T's substantial rate cuts in each of the past three years. The rate cuts resulted primarily from reductions in connection fees charged to AT&T by local telephone companies.

"To target the new [reduced] rate of return and reflect reductions in access charges, AT&T lowered prices significantly on January 1, 1987." (AT&T 1986 Annual Report, pp. 15-16, dated Feb. 9, 1987.)

MCI has expressed concern that FCC regulation will drive interstate rates down further. MCI appears to view deregulation of AT&T as in MCI's interest, because AT&T could then increase long distance rates, and MCI, in lock-step, could raise rates under the AT&T umbrella. ("New MCI Strategy: Deregulate AT&T", New York Times, March 6, 1987, p. 36) AT&T's Chairman has responded by saying that if

AT&T is deregulated: "Frankly, it will be better for everyone, including our competitors". (Wall Street Journal, March 23, 1987, p. 6). This type of cooperation is not indicative of effective competition, and the consumer is the loser.

RHCs could serve as an effective check on this oligopolistic market power and could offer consumers additional alternatives. Entering long distance competition with facilities-based services requires an expenditure of capital which few companies can afford. Barring from this market seven RHCs which are potential entrants makes it unlikely that consumers will ever get many of the possible benefits of equal access.

Whether or not the RHCs ever fully enter the market, the threat of their entry would help limit the market power of current participants. Even modest RHC entry could help bring the benefits of competition to additional consumers. For instance, if the RHCs could do least cost routing for consumers, this could increase the use of less well known interexchange carriers which may charge lower rates, and thus could allow consumers to make a more informed purchase each time a long distance call is made. Allowing this route selection service to be offered through the network would also reduce the need for those businesses that desire this service to purchase and maintain expensive equipment. Lower costs and increased efficiencies would result.

The interexchange services restriction interferes with the ability of the RHCs to provide services in the manner most beneficial to consumers. For instance, the restriction requires that carriage of RHC cellular, two-way mobile or paging radio services across LATA boundaries be on facilities leased from interexchange carriers rather than on the RHC affiliates' facilities. However, the Court has recognized that the LATA boundaries were drawn with reference to landline services rather than to radio services and that the application of LATA boundaries to radio services may result in competitive disadvantage for the RHC services, lost efficiencies, higher prices and inconvenience to customers (578 F. Supp. at 648-9).

As an example of this problem, cellular service to customers in the Detroit area was disrupted when Pacific Telesis purchased that area's system. Cells had to be turned off, and the system had to be reconfigured at great expense, because the system provided service between LATAs. Even after reconfiguration, forcing this and other RHC systems to operate within LATAs has reduced the potential efficiencies of these systems. RHC cellular systems normally cover more than one LATA. Thus, a cellular call must be routed off of an RHC system and then routed back onto the system everytime a customer crosses LATA boundaries, boundaries which were designed without reference to traffic patterns and other factors of essential importance to cellular service.

The unreasonableness of the interexchange services restriction is particularly apparent with regard to its application in areas outside of the telephone service areas of an RHC (e.g. the Detroit area Pacific Telesis cellular system). In such areas, the RHC does not have a local network and thus could not have perceived "bottleneck" control of facilities used by other providers and could not discriminate against competitors. Removing this restriction would allow RHCs to compete not only with existing interexchange carriers but also with each other throughout the country. Allowing an RHC to resell other companies' interexchange services, to which new features could be added, would help expand competition in areas where the RHC does not have its own facilities. The companies whose services the RHCs could purchase for resale would benefit from increased revenues, and consumers would have additional options for their telecommunications transmission needs.

Application of the interexchange services restriction to bar RHC services between the United States and foreign countries, a market in which AT&T is totally dominant, prevents needed competition. Communications between the U.S. and foreign markets are far too important to U.S. trade and competitiveness to leave this market to AT&T and Japanese and other foreign corporations. America needs a strong and competitive presence in this market to ensure high quality, efficient and reasonably priced international services.

The RHCs have no advantage in entering international markets. To the contrary, they will enter such markets under enormous handicaps, just as they will face formidable hurdles if they enter the domestic interexchange market in head-to-head competition with AT&T, MCI, US Sprint and others who have had the advantage of years of experience in this market. There is no justification for continuing to protect these competitors. Permitting Pacific Telesis and the other RHCs to compete in the interexchange market will contribute to lasting, healthy competition.

Without this freedom, the RHCs will be prevented from providing consumers and our nation with the benefits such competition can bring. Dr. Peter Huber's prediction of things to come if the MFJ restrictions continue to prevent the RHCs from

participating, and from helping consumers to participate, fully in telecommunications markets, paints a somber picture of the future role of the interexchange services restriction, as well as of the other MFJ restrictions:

"At the moment the RBOCs may not build out; with the exception of customer premises equipment, they may not even resell. * * * As other major companies establish themselves as full-service, end-to-end suppliers, and move their prices for the piece parts into line with cost, the RBOC will become the supplier of last resort—the carrier that provides only what AT&T, IBM/MCI, Wang, British Telecom, Contel, or NEC, don't care to bother with. Of course some connections to the RBOC networks will always be needed . . . But there is virtually no limit to how far additional intelligence in the private nodes can substitute for [local exchange carrier] lines and services. And of course the RBOCs will remain system integrators for the poor, the tired, and the hungry. But this undoubtedly important responsibility is one that few for-profit companies will choose as their only one. It remains quite possible that the RBOCs will become the U.S. Post Office of electronic telecommunications, absolutely essential to many, with steady or even growing traffic, shored up by an obsolete statutory monopoly, but moribund nonetheless." ("The Geodesic Network, 1987 Report on Competition in the Telephone Industry", Peter W. Huber, independent consultant to the Justice Department, January 1987, p. 1.23).

Policymakers, RHCs and others who are concerned by this prediction that the MFJ restrictions could result in the near death of the RHCs, and thus of our nation's public telecommunications network, were offered little solace by the Court's September 10, 1987, order, which did not waive any aspect of the interexchange services and manufacturing restrictions.

THE RESTRICTION IS NOT NEEDED TO PROTECT RATEPAYERS AND COMPETITION

Any ability the Bell System once might have had to discriminate effectively in the interexchange market has been eroded by divestiture, by changes in the marketplace and by new regulations. Undoubtedly, for many customers and particularly the small user, the local telephone companies of the RHCs are, and will continue to be, the sole provider of local exchange telephone service. In fact, Dr. Huber suggests that without release from the MFJ's restrictions, in the future the only role of the RHCs will be to serve the small user (Huber Report, *Id.* at 1.23). But the "single circumstance" that the RHCs continue to serve as the sole provider of local exchange telephone service for many users is not a sufficient basis for restricting the RHCs where other factors such as equal access, effective regulatory controls and market forces stand squarely in the way of transferring local exchange market power to the interexchange telecommunications market. (See 552 F. Supp. at 187.)

With the development of equal access, any potential attempts at discrimination in offering local exchange services have been made futile. Regulators and competitors would easily perceive any attempts by an RHC to violate the rigorous equal access requirements.

If the RHCs entered the interexchange business, they would be new to it and would face stiff competition, including that from AT&T itself. With equal access substantially completed and with the pre-subscription balloting process for customer selection of an interexchange carrier completed, customers have already had an option to choose a new long distance carrier. Thus, entry into this market would be harder now than ever before. These competitive forces which have developed since divestiture would work to prevent anticompetitive behavior by the RHCs.

Another major change since divestiture has been the development by the Federal Communications Commission (FCC) and state regulators of accounting safeguards (e.g. FCC approved cost allocation manuals) and other protections for ratepayers and competition to be applied as RHCs enter new businesses. The independent but similarly situated RHCs give regulators the ability to make useful comparisons in developing safeguards. The RHCs, along with GTE, provide regulators with a set of benchmarks that allow them to determine whether one company or another is engaging in anticompetitive activities. Such comparisons were not possible in the unified Bell System prior to divestiture.

The MFJ restrictions prevent regulators from implementing these safeguards to allow the benefits of RHC competition. The interexchange services restriction stands in the way of the FCC's ability to determine whether, to what extent, and with what regulatory safeguards RHCs should be allowed into interstate telecommunications markets. Thus, the restriction conflicts with Congress' mandated role for the FCC, as set forth in the Communications Act of 1934, to "make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and worldwide wire and radio communication service with adequate facilities at reasonable charges" (47 U.S.C. 151). The restriction also is inconsistent with the FCC's author-

ity to regulate interstate common carrier services under Title II of the Communications Act.

In addition, the restriction is inconsistent with state authority over the provision of intrastate interexchange telephone services. As the District Court noted in 1982, "the States are closely regulating . . . the types of business operations in which the Operating Companies may engage" (552 F. Supp. at 158 n. 110).

Under state and federal regulation, several local exchange companies provide interexchange services. Most widely known is GTE, which was allowed by governmental bodies to acquire Sprint even though GTE owns several local exchange companies. GTE has contributed substantially to interexchange competition, and there have been few complaints concerning the relationship of its interexchange services to its local exchange companies. GTE has been joined by United Telecommunications which operates 20 local exchange companies. By almost any standards, GTE is larger than any single RHC, and the involvement of GTE and United in both the local exchange and the interexchange markets has been good for the industry and for consumers. There is every reason to believe that similar involvement by the RHCs would bring similar benefits.

CONCLUSION

Billions of dollars have been spent to provide interexchange carriers with equal access to the RHCs' telecommunications networks. But only limited competition has developed, and ratepayers have not received many of the benefits expected. Allowing RHCs to enter interexchange markets would help create the vigorous competition which is needed in these markets to bring to consumers the benefits of new and better services and of lower prices than otherwise will be possible.

Whatever justification there might have been for the District Court to retain jurisdiction over RHC interexchange services for a time after divestiture, such justification is gone. The development of competitive forces and the experience with competitive markets which has been acquired by federal and state regulators during the ensuing years mandate transferring that jurisdiction back to regulators, with Congress setting national telecommunications policy.

STATEMENT OF THE COMPUTER AND BUSINESS EQUIPMENT MANUFACTURERS ASSN. (CBEMA)

CBEMA is pleased to submit this statement to the record of the Senate Commerce, Science and Transportation Subcommittee on Communications for this oversight hearing on the Modified Final Judgment (MFJ). CBEMA has a long record, both at the FCC and the Courts, of advocating the competitive goals established by the MFJ. CBEMA represents the leading edge of American high technology companies in computers, business equipment and telecommunications. Its members had combined sales of more than \$185 billion in 1986, representing 4.3% of our nation's gross national product. They employ more than 1.2 million people in the United States. A list of member companies is attached.

CBEMA fully supports the goal of fair and open competition in the telecommunications marketplace. Because of the continuing bottleneck monopoly power of the RBOCs and the absence of fully tested and effective safeguards necessary to check the abuse of this monopoly power, CBEMA supports Judge Greene's decision concerning the MFJ restrictions with regard to RBOC manufacturing, interexchange services, and provision of information services.

When, and only when, the Court deems that conditions warrant removal of these restrictions, CBEMA asserts that removal should be conditioned as follows:

These are essentially anti-trust issues and therefore the Courts have rightly taken the lead in resolving them. When the Court deems that conditions warrant removal of these restrictions, removal should be conditioned as follows.

1. Safeguards that have been fully tested and demonstrated to be effective in preventing unfair competition, as well as protecting ratepayer interests, should be applied to the boundary separating competitive and regulated operations of the RBOCs; specifically, accounting and cost allocation procedures to prevent cross-subsidies, an implemented Open Network Architecture (ONA), and rules pertaining to network information disclosure and customer proprietary information to prevent discrimination.

For example, CBEMA believes that the Court should adopt safeguards in the provision of the limited videotex gateway functions recently authorized. Performance by the RBOCs in providing the limited gateway functions should provide some indication of the point when the safeguards are adequately tested and demonstrated to permit the RBOCs to extend their provision of information services.

2. RBOCs must commit to uniform nationwide interconnection and interoperability standards.
3. RBOCs which enter into manufacturing of telecommunications products should implement firm policies and practices of fair and open procurement. In addition, prohibitions should be established against joint ventures that expand or unfairly exploit the "captive market" power of the RBOCs in procuring equipment.

CBEMA encourages continual oversight by both the Court and the FCC of telecommunications activities. As recognized by the Federal Government in 1982, the antitrust laws provide for important structural remedies such as divestiture, which the Communications Act does not authorize. The FCC is continuing to experiment with new methods of regulating providers of telecommunications, such as Open Network Architecture (ONA), to prevent a repeat of the anti-competitive accumulation of monopoly power which led to the divestiture and line of business restrictions in the MFJ. If these new methods succeed, then CBEMA believes it would be appropriate for the Court to consider relaxing restrictions in the MFJ and permit fair and open competition between the RBOCs and the providers of unregulated competitive services. The FCC is the appropriate entity to develop these regulatory solutions. Until these solutions are perfected, however, the court should continue its supervision of the MFJ.

United States Senate

COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-8275

JOSEPH R. BIDEEN, JR., DEL., CHAIRMAN

EDWARD M. KENNEDY, MASS.
ROBERT C. BYRD, W. VA.
HOWARD M. METZENBAUM, OHIO
DENNIS DECONCINI, ARIZ.
PATRICK J. LEAHY, VT.
NOWELL HEFLIN, ALA.
PAUL SIMON, ILL.

STROM THURMOND, S.C.
ORRIN G. HATCH, UTAH
ALAN E. SIMPSON, WYO.
CHARLES E. GRASSLEY, IOWA
ARLEN SPECTER, PA.
GORDON J. HUMPHREY, N.H.

MARK H. GUTENBERG, CHIEF COUNSEL
SUSAN HOFFMAN, STAFF DIRECTOR
DENNIS W. SHEDD, MINORITY CHIEF COUNSEL

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

HOWARD M. METZENBAUM, OHIO, CHAIRMAN
DENNIS DECONCINI, ARIZ.
NOWELL HEFLIN, ALA.
PAUL SIMON, ILL.
EDWARD M. KENNEDY, MASS.
STROM THURMOND, S.C.
ARLEN SPECTER, PA.
GORDON J. HUMPHREY, N.H.
ORRIN G. HATCH, UTAH
EDDIE CORREA, CHIEF COUNSEL AND STAFF DIRECTOR
KENNETH G. STARNUM, MINORITY CHIEF COUNSEL

December 10, 1987

Senator Daniel K. Inouye
Chairman
Subcommittee on Communications
Committee on Commerce, Science and Transportation
Washington, D.C. 20510

Dear Chairman Inouye:

I commend you for holding hearings in your Subcommittee on Communications on the AT&T Consent Decree. Earlier this year I too held hearings on the Decree in the Subcommittee on Antitrust, Monopolies and Business Rights. As a result of the extensive record we developed, I am taking the liberty of sharing with you my views in this area, and ask that this statement be included in the record of the hearing.

As chairman of the Antitrust Subcommittee, I have a deep and ongoing interest in the Decree, particularly the restrictions which keep the Bell Companies out of telecommunications markets in which they could leverage their monopoly control of the local exchange to harm competition and the local ratepayer. I believe those restrictions are absolutely essential to the growth of competition in the telecommunications industry and to the protection of the local ratepayer. I also believe Judge Greene is doing an able job of administering those restrictions and calling to task an Administration which no longer wishes to uphold and enforce them.

Despite evidence that the Decree has promoted competition in telecommunications, the Department of Justice, as you know, no longer supports most of the line of business ("LOB") restrictions. To gain a better understanding of the Department's position, I chaired hearings in the Antitrust Subcommittee last April 30. The record of that hearing, which includes the testimony of the Department of Justice, consumer representatives, state public utility commissions, regional

Bell operating companies, and a vast array of telecommunications providers, overwhelmingly documents the continuing need for the LOB restrictions in nurturing competition and in protecting ratepayers from cross-subsidization and other abuses of monopoly power.

While recommending relaxation of the LOB restrictions, the Department of Justice acknowledged that the Bell Companies' local telephone monopolies -- the antitrust predicate of the restrictions -- remain virtually as strong today as they were at the time of enactment of the Decree.

The Consumer Federation of America and the National Association of State Consumer Utility Advocates testified that local telephone rates have gone up dramatically since divestiture -- nearly 40% in my own state of Ohio -- and that lifting the restrictions would harm competition and the ratepayer by giving the Bell Companies the incentive to shift more costs into the local rates.

The chairperson of the Washington State Utility and Transportation Commission and representative of the National Association of Regulatory Utility Commissioners emphasized the enormous difficulty that regulators have policing the cash flows between a telephone monopoly's regulated and unregulated affiliates.

AT&T, MCI, and Comptel, a long distance trade association, argued that lifting the restrictions while the Bell Companies retained their local monopolies would pose a major threat to the continued growth of competition in the long distance market.

The American Newspaper Publishers Association, representing information service providers, testified that while the Bell Companies retain their local exchange bottlenecks, their role in the electronic publishing market should be limited to providing underlying transmission and related services.

Finally, Bell South and Ameritech urged the removal of the LOB restrictions, asserting that Bell Company entry into long distance, manufacturing, and information services would promote competition and bring important new benefits to the consumer.

Judge Greene's recent rejection of the Justice Department's recommendation to eliminate most of the LOB restrictions is in keeping with the record of our April 30th hearing. The centerpiece of the Court's decision was its

finding that the Bell Companies retain their natural monopolies and that competition in the local exchanges is not economically feasible. On the basis of this finding, the Court concluded that the Bell Companies continue to have the ability to use their local monopoly bottlenecks to impair long distance and manufacturing competition and refused to lift the restrictions on those activities. On the other hand, the Court did modify the information services restriction to enable the Bell Companies to build the necessary infrastructure, or "gateway," for the transmission of information services and data bases owned by others.

Judge Greene's decision is judicially sound and entirely consistent with the legal principles of the AT&T case and the record of our hearing in the Antitrust Subcommittee. It is therefore upsetting that the Administration continues to do all it can to circumvent the Decree (its recent motion asking the FCC to authorize the Bell Companies to provide information services is merely the latest attempt) and that the Justice Department continues to shirk its responsibility for enforcing it.

In the latter regard, I and Judge Greene have been complaining to the Justice Department for months about non-enforcement. Just last week, Judge Greene again admonished the Department for sitting on complaints, failing to respond to requests for enforcement of the Decree, and failing to inform the Court that requests for enforcement had been made. It is increasingly clear that the Department is unable or unwilling to carry out its responsibilities and that vigilant oversight by the Court and the Congress will be necessary to ensure that the Decree is enforced.

Again, let me commend you for holding these hearings. I am confident that after you listen to the testimony you will conclude, as I and Judge Greene have, that the line-of-business restrictions on the Bell Companies remain vitally necessary to the protection of competition and consumers in the telecommunications industry.

Sincerely,



Howard H. Mollenbaum
Chairman
Senate Subcommittee on
Antitrust, Monopolies and
Business Rights

December 8, 1987

The Honorable Daniel K. Inouye
Chairman
Subcommittee on Communications
Committee on Commerce, Science & Transportation
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We ask that this letter be made part of the record in the hearings now being held on the current issues involving the Modified Final Judgment (MFJ) in U.S. v. Western Electric Co., Civ. Act. No. 82-0192, D.C.D.C.

Before succinctly stating our views, we should make clear our interest in this matter. As disinterested persons with extensive governmental and professional experience in this area, we submitted comments to the District Court ("antitrust court" or "court") on the proposed modified decree in 1982 and, joined by Dr. Parker, again in 1987 on the recent reconsideration of the restrictions imposed on the divested Bell Operating Companies (BOCs). We have included a copy of that recent pleading with this letter so that, if desired, the Subcommittee will have the benefit of a fuller elaboration of our views. Those views have remained consistent from 1982 to the present.

I. Information Services.

We strongly believe that the ban on provision of information services diserves the national interest because it prevents or markedly inhibits over one-half of the U.S. telecommunications industry (the BOCs) from making a much needed contribution to the development of the U.S. information society. The ban was wrong in 1982 when it was imposed by the Department of Justice (DOJ), and acquiesced in by AT&T. It is even more wrong today. DOJ has come to recognize this, and AT&T does not oppose its elimination. But, despite the fact that the plaintiff seeks relief (unopposed in this respect by the defendant) as to a consent judgment, the antitrust court insists on generally continuing the ban. In its September 10th decision, the court has said it will modify the ban only to permit BOC provision of the infrastructure needed for a massive videotext operation.

We believe that the restriction should be eliminated entirely. The BOCs should be permitted generally to engage in protocol and code conversion so that they can serve as universal gateways for data transmission as they do for voice. They should be allowed to engage fully in voice storage and forwarding (or "voice mail").

Indeed, we stress that there is no way to forecast what information services will be developed. These are not easy services to initiate or establish. The BOCs have the resources and the expertise to be critically important leaders for our nation as it moves into the information society, along with other highly industrialized nations like Japan, West Germany, France, the United Kingdom. These resources and expertise are lost unless the court eliminates the ban on information services altogether. No one can now quantify precisely what will be lost if we do not obtain the benefits of competition from these seven large telecommunications entities, all independently doing their own strategic planning. What we can say, knowing their resources and the genius of such competition, is that the costs to the nation will be large.

There are several other points to be made here:

- (i) Large users can purchase sophisticated customer premises equipment to provide information services like voice storage and forwarding, protocol conversion, etc. However, the small business or the residential user cannot afford such equipment and thus is dependent on the network for the provision of these valuable enhancements. Thus, the residential and small business users will be the losers if the BOCs are prevented from generally providing these services.
- (ii) Our telecommunications equipment market is wide open to foreign competition and indeed there is an imbalance in the trade area in this respect. By precluding the telephone network from making its full contribution, we are thus skewing the competition towards equipment and away from the area where the U.S. has an advantage.
- (iii) Equally important, the ban obviously inhibits the upgrading of the network so that new services can be offered and, over time, be made available to all users.

The Subcommittee should recall that a major driving force behind AT&T's agreement to the MFJ was its need to eliminate the 1956 Consent Decree which was preventing its entry into information processing. Because of the driving technology -- the merging of telecommunications and data processing -- AT&T concluded that it had to be in the business of information movement and management. By 1982, it was widely acknowledged that the 1956 decree constituted bad policy. Yet, the MFJ repeats the mistake and applies that same flawed policy to the BOCs, similarly situated and driven to enter the new information services.

The Subcommittee need only look to the actual example of GTE -- in effect, the equivalent of a BOC (with \$12 billion in assets). GTE's entry into information services has markedly bolstered competition and served the public interest. Suppressing GTE would have clearly resulted in a large net loss.

The antitrust court based its action on the consideration that the BOCs still possess bottleneck facilities essential to the providers of information service. The BOCs do possess such facilities. Indeed, it will take time for truly competitive alternative distribution systems to develop for many types of information services. This means that the judicial suppression of BOC competition is not a short-term restriction to be tolerated for a few years; under the antitrust court's restrictive

approach: the BOCs' contributions will be suppressed or largely inhibited for the remainder of this century.

BOC entry fully into information services will be messy since it will entail regulation to insure fair interconnection for other information providers and to protect against improper cross-subsidization. The Federal Communications Commission (FCC) has taken substantial steps in this respect (e.g., the use of the fully separated subsidiary for competitive activities; or, where the service is integrated into the network, specified accounting with independent audits and comparably efficient interconnection; and, ultimately, "open network architecture"). These regulatory safeguards will not be perfect. But on balance they will constitute substantial protection against abuse. Thus, the Subcommittee should look to the experience in the protocol and code conversion area where FCC process resulted in tailored protection, or to the more recent and ongoing process as to voice storage and forwarding. The antitrust court characterized this latter process as defective because a BOC request had been met with a storm of protest as being anticompetitive. But the court is wholly wrong; the protest by interested and expert entities -- and the response by the BOC involved -- shows that the process works, not that it is defective.

Most important, the appropriate test here has to be one of cost-benefit; that is, of balancing detriments and pluses. If competition and the nation are much better served by BOC entry than exclusion, then that entry is clearly warranted. That is the case with BOC entry into the provision of a full range of information services. But the antitrust court has chosen to apply a different test -- whether there is a substantial possibility that BOC entry could inhibit competition. Since the BOCs do own essential facilities, the court ruled that, with one exception for videotext infrastructure, the prohibition should be retained. However, in making that exception, the court abandoned its own test and looked to overriding competitive or national benefits. This inconsistency simply points up the court's fundamental error -- the court should have employed the cost-benefit test generally. The court is so concerned about preventing any potential harm to competitors that it is willing to deny consumers all potential benefits. The court's action is thus reminiscent of the statement by the U.S. officer in Vietnam: "We had to destroy Bien Loc in order to save it."

We have focused on policy issues since they are clearly a matter for Congressional concern. There are serious legal issues here (e.g., the failure to modify a consent decree when all parties concur or do not object; the use of the wrong standard and its inconsistent application; denial of First Amendment rights; the conflict with FCC policies based on the Communications Act of 1934, as amended). Since these issues are more appropriate for appellate review, we will not address them here. But there is one aspect of the conflict between antitrust and FCC purview that we believe should be considered by the Congress: the confusion and uncertainty engendered by the conflicting antitrust and FCC processes.

The FCC has found that BOC entry into protocol and code conversion markedly serves the public interest and has held extensive proceedings to ensure that such entry occurs on fair terms. The FCC is now engaged in a similar process as to voice storage and forwarding. And it has embarked on an ambitious program to develop "open network architecture."

The antitrust court, however, has indicated that no regulatory scheme is satisfactory as to voice storage and forwarding, and that protocol and code conversion should be performed under a limited waiver only as it relates to the massive videotext infrastructure. The court is conducting further proceedings (really the equivalent of an FCC rulemaking proceeding) to delineate the exact terms of BOC provision of such information service. The antitrust court has undertaken the difficult task of seeking to "fine-tune" the BOC information service area. Because of the dynamic nature of the industry and of the underlying technology, "fine-tuning" will be necessary virtually forever. This Subcommittee has the responsibility to ask how this antitrust court process will affect the FCC's ongoing process.

There are other public policy issues raised by the court's September 10th decision. Ironically, the antitrust court is creating a cartel when it says "yes" to electronic white pages (since electronic directory service is essential to a massive videotext operation along the lines of the French model that the court has adopted), but "no" to electronic yellow pages. The court provides no rationale for this distinction. The irony arises from the fact that information for electronic yellow pages would be provided by the advertiser, not the phone company. A telephone-based system of electronic yellow pages would be the most efficient way for advertisers to supply and update the information they wanted customers to have. Yet, because of the court's long-standing preoccupation with protecting the newspaper industry, it assumes the role of cartel manager and prevents the BOCs from providing an electronic version of their traditional yellow pages directories which might somehow threaten the publishers' advertising revenues.

The present process is thus a sure prescription for confusion and conflict, and it will grow worse over time. We therefore strongly urge that Congress, as the overseer of the entire process, should take steps to insure orderly process. In our view, that means that the FCC regulatory process should govern, with appropriate judicial review and Congressional oversight.

We have one final observation here. Divestiture was a disruptive process. It is by no means assured today that the benefits sought -- in the long-distance and manufacturing areas -- justify the vast changes in industry structure brought about by divestiture. In our view, the justification will be a serendipitous consideration -- that we will have cloned AT&T seven times, and will have obtained great benefits from such pluralism in strategic planning. The present approach of the antitrust court cuts strongly against obtaining fully these vital benefits.

2. Manufacturing CPE and Telecommunications Equipment.

Competition in customer premises equipment (CPE) manufacturing is fierce. Many of the competitors are large enterprises with substantial vertical integration into telecommunications services (e.g., AT&T, Northern Telecom, IBM, Siemens). The established presence of these firms, along with the protections provided by the FCC's registration program, means that entry by the BOCs into the manufacturing of CPE would be most unlikely to impede competition. It is therefore poor public policy to prevent any BOC contribution to such competition, including research and development (R&D) efforts which are infeasible without the manufacturing base.

The market for telecommunications equipment (especially switching and transmission) must be viewed differently. This market is much less competitive than CPE markets. For example, the market for central office switches is essentially a duopoly dominated by AT&T and Northern Telecom. In addition, there are valid public policy and antitrust concerns that the BOCs might favor a manufacturing subsidiary which is less efficient than its competitors.

On balance, however, we come down in favor of lifting the restriction on manufacturing telecommunications equipment. First, we are concerned about forcing the BOCs to continue to rely on a major competitor (AT&T) or on a foreign-based supplier (Northern Telecom) for their switching needs. As "open network architecture" evolves and as the BOCs begin to offer information services, it is imperative that they be able to control their own destiny by establishing their own manufacturing capabilities or by engaging in joint ventures with others. Without the capability to manufacture, the BOCs are not likely to engage substantially in the R & D that is vital in dynamic markets. Moreover, there is a host of other activities including one-of-a-kind installations, software development and development of product specifications which may be said to include elements of "manufacturing." Thus, the prohibition on manufacturing casts a cloud on such activities and might well preclude them altogether. Our concerns are heightened by the antitrust court's December 3rd decision which interprets the manufacturing prohibition to extend to design and development, as well as fabrication. We note that, in its decision, the court has assumed the role of determining in the future what constitutes "exchange network design" and what constitutes "design of telecommunications equipment" -- hardly a matter within the competence of a federal district court applying the antitrust laws.

As to potential abuses of market power by the BOCs in the purchasing of telecommunication equipment, a BOC cannot earn significantly more monopoly rents by producing its own telecommunications equipment. We thus believe that the potential benefits far outweigh any harm to competition, since lifting the manufacturing bar may create additional competition and eliminate the duopoly which exists in the manufacture of central office equipment.

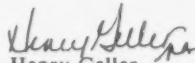
3. InterLATA.

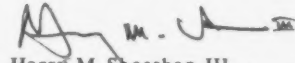
We do not disagree with the decision to retain the bar against BOC provision of service between Local Access and Transport Areas (LATAs) at this time. Until the equal access process has been completed and until consumers have become fully acclimated to the equal access environment, across-the-board entry by the BOCs is not warranted. However, it is clear to us that waivers (including blanket waivers) may well be appropriate in particular circumstances where competition and the public interest would, on balance, be served. We are concerned with the court's rigid stance against waivers of the interLATA prohibition. Even in the recent case involving FTS 2000 where the court granted a waiver, it did so without reaching the issue of whether any of the features involved in the BOCs' offering amounted to interLATA service. Thus, the court avoided a potentially embarrassing situation -- having the MFJ used by AT&T to disqualify the only other competitive FTS bidder -- without doing anything

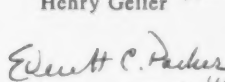
to eliminate the confusion about what constitutes interLATA service. Our point here is that assertions flatly proscribing any BOC participation in this respect are inappropriate. The governing standard remains the national or public interest -- not shibboleths.

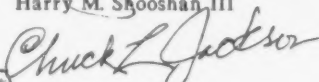
We hope that the foregoing is helpful to you in your consideration of this matter. We commend the Subcommittee for holding these hearings. No more important issue exists in the telecommunications field.

Sincerely yours,


Henry Geller


Harry M. Shooshan, III


Everett C. Parker


Charles L. Jackson

TIMOTHY E. WIRTH
COLORADO

United States Senate

WASHINGTON, DC 20510-4702

COMMITTEES
ARMED SERVICES
BANKING
BUDGET
ENERGY AND
NATURAL RESOURCES

December 7, 1987

Mr. Jack A. MacAllister
Chairman of the Board and
Chief Executive Officer
U S West Inc.
7800 East Orchard Road, Suite 200
Englewood, Colorado 80111

Mr. George Wilson
Chairman
American Newspaper Publishers Association
Box 17407 Dulles Airport
Washington, D.C. 20041

Gentlemen:

I am writing to express my support for the joint order U S West and the American Newspaper Publishers Association (ANPA) recently filed with the divestiture court on information service access. I believe the proposed U S West-ANPA order represents an important breakthrough for the telephone and information service industries that could mean significant benefits for the American consumer and economy. As our national and international economies depend more and more on the exchange and management of information, it is critical that we adopt policies that provide for the development of state-of-the-art telecommunications networks and a competitive information service industry.

The joint order filed with the court on October 15 by U S West and ANPA would appear to provide the framework necessary for the development of a competitive and diverse information service marketplace in the United States that promises to bring consumers and businesses a wide array of new and innovative services. And, importantly, I believe the proposed order would work to preserve and promote the First Amendment goal of encouraging the widest possible diversity of information sources by ensuring that the owner of dominant transmission facilities does not hold a financial interest in any information service provider. The proposed order also incorporates important nondiscrimination requirements to encourage the development of a competitive information services marketplace.

1129 PENNSYLVANIA STREET
DENVER, CO 80203
303/868-1500

1003 MAIN STREET
GRAND JUNCTION, CO 81501
303/245-8044

830 N. TEJON ST.
SUITE 105
COLORADO SPRINGS, CO 80903
303/624-5523

UNITED BANK BUILDING
8TH AND MAIN ST.
SUITE 410
PUEBLO, CO 81003
303/542-6987

Page Two
December 7, 1987

In my view, the U S West-ANPA proposal is fully consistent with the Court's decision to promote the broad availability of information services for consumers and businesses. The "information gateway" envisioned in the U S West-ANPA filing would allow both information service providers and consumers to make efficient use of the full capabilities of the telephone network now and in the future.

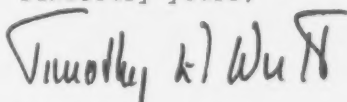
For example, the gateway would allow information service providers to interconnect with any type of premises communications equipment, from home telephones to sophisticated computers. In addition, the gateway would help consumers locate the information providers and services they desire, and will assist information service vendors in identifying the needs of their customers. The gateway would also assist information service providers with customer related services, such as billing and rate information.

As a former chairman of the House Telecommunications Subcommittee and as a veteran of the long-standing debate concerning electronic publishing, I know just how difficult it must have been to reach agreement on this important matter. You are to be commended for your hard work and effort.

I look forward to continuing to work with you and others in the communications industry to help ensure that the American public has access to the growing benefits of the information age.

With best wishes,

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Timothy E. Wirth". The signature is stylized, with the first name "Timothy" written in a cursive-like script and the last name "Wirth" in a more blocky, capital-heavy style.

Timothy E. Wirth

○